OVERSIGHT OF U.S. TRADE POLICY

JOINT HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

AND THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY

OF THE

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CONTENTS

ADMINISTRATION WITNESS

Page
Haig, Alexander M., Jr., Secretary of State ... 147, 180

PUBLIC WITNESSES

American Express Co., Harry L. Freeman, senior vice president ... 95
AFL-CIO, Lane Kirkland, president ... 1
Emergency Committee for American Trade, Edmund T. Pratt, Jr ... 33
Freeman, Harry L., senior vice president, American Express Co ... 95
Geier, James A. D. president and chairman of the board, Cincinnati Milacron, Inc ... 79
Huddleston, Hon. Walter D., U.S. Senator, Kentucky ... 112
Kirkland, Lane, president, AFL-CIO ... 1
Mathias, Hon. Charles McC., U.S. Senator, Maryland ... 111
Pratt, Edmund T., Jr., chief executive officer, Pfizer Chemical Co. for Emergency Committee for American Trade ... 33
Simmons, Richard, president, Allegheny Ludlum Steel Corp ... 55
Snyder, Susan L., president, Pathfinder Corp ... 124

ADDITIONAL INFORMATION

Information on Monitoring Imports ... 16
Letter from Rudy Oswald to Robert E. Chasen ... 17
Prepared statement of:
    Kirkland, Lane, president, AFL-CIO ... 21
    Pratt, Edmund T., Jr., chairman, Emergency Committee for American Trade ... 41
    Simmons, R. P., president, Allegheny Ludlum Steel Corp ... 63
    Geier, James A. D., president and chairman of the board, Cincinnati Milacron Inc ... 83
    Freeman, Harry, senior vice president, American Express Co ... 100
    Mathias, Sen. Charles McC., Maryland ... 113
Letter to Senator Mathias from Gov. Dick Thornburgh, Pennsylvania ... 115
Prepared statement of:
    Huddleston, Sen. Walter D., Kentucky ... 116
    Susan L. Snyder, president, The Pathfinder Corp. for International Trade. 132
Committee press release ... 142
Letter to Senator Bradley from Richard Fairbanks ... 160
Opening statement of Senator Heinz ... 143
Prepared statement of Secretary Haig ... 180
Answers by Secretary Haig to Senator Heinz's Questions ... 194

COMMUNICATIONS

Statement of Hon. Donald T. Regan, Secretary of the Treasury ... 199
American Farm Bureau Federation, Vernie Glasson, director, National Affairs Division ... 396
American Importers Association ... 411
American League for Exports and Security Assistance, Inc., Armistead I. Selden, president ... 238
Blinken, Robert J., chairman, United States Fastener Manufacturing Group.... 371
California Avocado Commission, Ralph M. Pinkerton, president ... 399

Page
Chinoin Pharmaceutical & Chemical Works Ltd 285
Connor, Joseph E., chairman, Price Waterhouse & Co 302
Donaldson, John C. L., president, Gray & Co 266
Electronic Industries Association 360
Glasson, Vernie, director, National Affairs Division, American Farm Bureau Federation 396
Gray & Co., John C. L. Donaldson, vice president, international 266
Haggart, Vernoica A., attorney at law 395
International Economic Policy Association, Timothy W. Stanley, president 441
International Harvester Co., Paul E. Johnson, vice president, special markets . 387
Johnson, Paul E., vice president, special markets, International Harvester Co . 387
Kilik, Eugene L., president, Tanners' Council of America 282
Levy, Edward S., executive director, National Handbag Association 408
Millers' National Federation, Wayne E. Swegle, president 219
National Cotton Council of America 226
National Handbag Association, Edward S. Levy, executive director 408
Pinkerton, Ralph M., president, California Avocado Commission 399
Price Waterhouse & Co., Joseph E. Connor, chairman 302
    U.S. Investment Abroad, a draft study 318
Selden, Armistead I., president, American League for Exports and Security Assistance, Inc 238
Stanley, Timothy W., president, International Economic Policy Association 441
State of Washington House Concurrent Resolution No. 4 277
Stroock, Stroock & Lavan 300
Sun Diamond Growers of California 391
Swegle, Wayne E., president, Millers' National Federation 219
Tanners' Council of America, Eugene L. Kilik, president 282
Taylor, George E., president, Washington Council on International Trade 248
U.S. Council for an Open World Economy 232
United States Fastener Manufacturing Group, Robert J. Blinken, chairman 371
Washington Council on International Trade, George E. Taylor, president 248

OVERSIGHT OF U. S. TRADE POLICY

MONDAY, JULY 13, 1981

U.S. SENATE, SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE COMMITTEE ON FINANCE AND SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY OF THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,

Washington, D.C.

The subcommittees met, pursuant to notice, at 9:30 a.m., in room 5300, Dirksen Senate Office Building, Hon. John Heinz (acting chairman) presiding.

Present: Senators Dole, Danforth, Heinz, Grassley, and Long.

Senator HEINZ [chairman, presiding]. This is the third day of hearings that the Subcommittee on International Trade of the Finance Committee and the Subcommittee of International Finance and Monetary Policy of the Banking Committee have held.

Last week, we heard from a number of members of the administration.

Today, we hear from a variety of people in the private sector.

Our first witness will be somebody who is no stranger to the members of both committees, the president of the AFL-CIO, Mr. Lane Kirkland.

STATEMENT OF LANE KIRKLAND, PRESIDENT, AFL-CIO

Senator HEINZ. Please proceed.

Mr. KIRKLAND. Thank you, Mr. Chairman.

My name is Lane Kirkland. I am president of the AFL-CIO. With me today are Ray Dennison, director of legislation with the federation, Elizabeth Yaeger, assistant director of research.

Mr. Chairman, the AFL-CIO believes the United States needs a modern trade policy. As the U.S. trades with more than 150 nations and territories, imports and exports of products will be worth more than one-half trillion dollars this year.

This trade will have a substantial impact on jobs, technology, investment and the industrial destiny of this Nation.

Policies to deal with the price to our Nation as well as the benefits of this enormous trade expansion should be restructured in a comprehensive, realistic and fair manner.

It is time for this change.

The AFL-CIO has heard the explanations for trade policy come full circle since World War II. As U.S. seamen watched the shipping industry decline and their jobs go to foreign flags, they were told that the United States is not a service nation but a manufacturing nation and that exports of manufactures create jobs.

However, in the three postwar decades, various types of manufacturers went into deficit: textiles, steel, shoes, autos, electronics, and some kinds of machinery. Each time exports of a higher technology product was given as the answer.

But the lost steel plants in Pennsylvania, autos in New Jersey, railroad parts in California, shoes and machinery in Missouri, and electronics, glass, rubber, and aluminum nationwide left expensive scars.

Increasingly, huge imports of parts were a major factor even in aircraft and computer sales.

So the dollar sign on export sales no longer always added up to jobs.

In fact, in 1980, the U.S. trade balance shifted from a surplus to a deficit of $32 billion. By 1981, the story is: "We must emphasize service industries in trade policy, because the United States is a service economy."

No such easy answers will solve complex problems.

The AFL-CIO believes the United States must be a diversified manufacturing, agricultural, and service economy, with the full complement of technological industries.

Anything less is a failure to develop the resources and industries this nation can provide for full employment and rising living standards. Trade is part of that goal—not the other way around.

A fair trade policy can help build that goal. A policy of Government abdication of responsibility in the name of free trade can make the losses from trade much higher than the gains for most Americans.

A fair U.S. trade policy would:

Provide a full account of what happens in the real world, a world where free trade does not exist. Other nations in the world do not apologize for pursuing their national interest. Yet the United States is under constant assault when suggestions are made to move in United States national interest.

Enforce U.S. laws and international agreements against unfair trade practices so as to allow U.S. producers and workers a chance to improve industries impacted by trade. Procedures that now inhibit appropriate responses should be simplified.

Monitor imports and exports and their impact on the U.S. economy. Such detailed monitoring is required now, but it does not exist. Without such monitoring, industries and workers are injured by imports are not able to make their case and solutions are not provided.

Achieve reciprocity. Where other nations bar U.S. products through one means or another, the opportunity to enforce U.S. laws to gain access should be encouraged to even out the burdens of the world. Equivalent access to foreign markets is key.

End the incentives U.S. firms now have to invest abroad in order to take advantage of multibillion dollar tax subsidies and insurance for overseas investment.

Firms that go abroad for cheaper labor should not be given subsidies to do so. These subsidies and pressures for expansion or relocation abroad should be repealed.

Repeal counterproductive laws. For example, the United States now grants zero tariffs or preferences for imports of more than 2,700 products from 140 nations and territories.

These special privileges, called the generalized system of preferences do not aid the neediest people abroad, and the imports injure U.S. industries and jobs.

This generalized system of preferences should be repealed. At a bare minimum, Congress and the administration should remove import-sensitive products from the list, guarantee that only the neediest countries receive the benefits, and exclude Communist economies.

Establish national security policy goals that provide not only an adequate defense but also a fully employed, strong economy. Only a strong United States that has the means to feed, house, clothe, and transport its population can provide adequate national security.

Provide realistic adjustment assistance for those injured by trade. The cost to the Nation of losing its pool of skills is severe. Millions of Americans have lost their jobs through no fault of their own as a result of trade policies.

Lost jobs, devastated communities and eroded tax bases dot the U.S. landscape. Yet these losses are not even measured, much less corrected.

Discussions of world trade barriers in Washington in 1981 lead the uninformed observer to believe the United States has many barriers to trade and the world has very few. The facts are the reverse.

The world's economies have planning, import regulations of all kinds, export requirements, and export subsidies, as well as requirements to produce within their borders.

No such protection exists for U.S. industry, which only can move abroad and or become importers. Much of U.S. industry already has moved. That is not fair.

Most nations of the world have content requirements or special requirements in law or practice that require companies to produce within national borders or to make a certain percentage of the content of a product, such as a car, or a machine in that country.

The United States needs to adopt such content laws for essential industries or it will become an assembler of foreign-made parts.

Other performance requirements may need special actions. Export requirements, for example, can be met by withdrawal of U.S. privileges to other countries under current law.

Attempts to carry out international agreements or other pursuits of U.S. rights are regarded as protectionism--but little attention is paid to actions of other nations against the United States and to constant barriers to U. S. exports. That is not fair.

Enforcement of existing laws--and improvement where they are failing--is therefore a first step toward fair trade. Subsidies, dumping, and other unfair trade practices, condemned in law--both nationally and internationally--have received relatively little effective action.

Even when injury is proven and violation of laws and agreements is well known, only occasional limited actions have been taken.

For example, steel has been subsidized and dumped in the U.S. market for a long time. But neither the U.S. law on dumping nor the international agreement has been widely enforced.

A trigger price mechanism to get the steel industry to withdraw its dumping suits was established and was helpful for a time. But the massive losses of American steel production continue in many products. Fabricated steel is not even monitored, so that loss is uncounted.

A U.S. petition for dumping action on imported TV sets received a positive finding in the late 1960's.

However, legal suits continued until June 1981 when the ITC ruled against the Japanese attempt to reverse earlier decisions. These U.S. actions were too little, too late, and in the meantime, the industry has been eroded.

The autoworkers and many other U.S. unions petitioned for relief from auto imports--injury that was obvious. The law designed to provide time for the industry to become competitive is section 201 of the Trade Act of 1974--and the escape clause of the General Agreement on Tariffs and Trade (GATT).

Thus the case was not a violation of any agreement or law. But the result was no action by the U.S. Government because American opinionmakers and policymakers did not want to grant relief.

Two Presidents told the Japanese there would be no restraints by the U.S. Government. The Japanese when finally convinced that some action had to be taken, put modest restraints on their exports. But U.S. producers of auto parts have received no help at all for their special problems.

No injured industry has ever achieved the relief it sought under section 201. Since the 1974 act was passed, only 9 of 45 cases have received any action on imports. The ITC usually recommends less than industry seeks--be it quotas or tariffs or tariff quotas--and the President ignores the ITC recommendation altogether or grants less than it calls for.

Specialty steel, color TV's, and shoes are examples of the industries where relief has been phased out or phased down. Industrial fasteners—nuts, bolts, and screws—received minimal relief and are currently seeking an extension.

These are just a few examples of major industries that are affected. Small producers of parts essential to these industries usually get no relief at all.

Under current procedures, the cost, the data requirements and the complex legalisms are so difficult to overcome that injured industries and groups of workers cannot afford to bring actions for relief from inrushes of imports or dumping.

This is not fair trade policy. This policy of inaction leads to more unfair trade. The law should be enforced, improved and emergency procedures established to prevent the outrush of key industries.

Textiles and apparel receive some help, but the barrage of complaints about this industry leads to a distortion of the size and importance of that help. It is unfair to expect the United States to continue to destroy its domestic textile and apparel industry and to charge the United States with protectionism in a protected world.

An international textile agreement—the multifibre arrangement—regulates this trade. It should be renegotiated to provide for orderly sharing of the U.S. market growth in the United States This is fair under international rules.

But reciprocity—equivalency of access to markets—is a fair trade concept that the U.S. policymakers do not consider.

Thus a U.S. exporter does not have equivalent access to the markets of Japan, or Brazil or Romania or the Soviet Union or most countries in the world, but the cry of protectionism is not leveled against these foreign governments—only against the U.S. producers who complain.

Some of the newest U.S. industries, like semiconductors and computers and aerospace, are good examples of U.S. industries that will soon be lost because our trade policy does not enforce reciprocity.

Instead, the industries can go to other nations, be protected within those markets and export to the United States or third markets.

U.S. policy, which tried to avoid any help to American producers in the United States, supports subsidies to the investors abroad in most nations of the world. This is not fair.

The AFL-CIO believes that the United States needs an improved trade adjustment assistance program for workers injured by imports. Experience for the past 20 years underscores the urgency of improving benefits for those who lose their jobs from this cause. The current budget would effectively end trade adjustment assistance. The paltry sum now available in the budget amounts to another broken promise to those who pay the price of trade liberalization.

Export promotion should be a Government priority. Exports of farm products, manufactured products, and raw materials are important.

AFL-CIO members work on farms and in factories and in offices and in services. They produce some of the world's most sophisticated, as well as some of the older, industrial products for export.

However, export policy is not the answer in a world where equivalency of access does not exist. Export promotion should be targeted for specific goals and should not include capital, technology, and price sensitive commodities.

To reduce inflation in food, it is important to restrict the export of commodities in short supply. The world trade in grain has become so complex that the AFL-CIO believes a National Grain Board, similar to the Canadian Wheat Board, should handle foreign sales of U.S. grain.

While we wish to encourage the export of coal and other materials, policy should be flexible enough to assure adequate energy supplies at home.

Export promotion should neither get priority over domestic budget needs nor be used as an excuse for blanket changes in U.S. antitrust or banking laws.

Stopping the incentives in our tax and trade laws for foreign expansion by U.S. firms and banks would help the United States to achieve both better trading arrangements and a better economy at home.

The principal traders of the world are now multinational banks, firms, and governments who are often their partners. Some governments are multinational entities. The governments of many countries—both Communist and non-Communist—have become huge multinationals.

Developing countries now spawn multinationals of their own. Most multinationals are no longer U.S. based, but the U.S. based multinationals still dominate U. S. trade. The tax and trade laws made this possible.

The multibillion-dollar tax subsidies available for U.S. based firms' operations, such as the Domestic International Sales Corporation, foreign tax credits, and the deferral of taxes on overseas profits are in direct conflict with national needs, such as the availability of capital at home.

No longer can they be justified as promoters of exports. They should be repealed.

The Overseas Private Investment Corporation should also be ended, since it encourages U.S. firms to invest abroad by insuring such investment against political risk.

For foreign multinationals in the United States, the AFL-CIO has urged adequate reporting. The AFL-CIO has also opposed raids or unscrupulous takeovers, and has called attention to the need to prevent takeovers in strategic industries.

In addition, the current influx of investments has led to many abuses and avoidance of U.S. labor laws. The AFL-CIO has consistently warned that U.S. laws and international codes on labor should be enforced.

The impact on U.S. trade of barter arrangements can be large. Pricing policies of the firms using barter and/or of a Communist country are not based on product cost as in a market system.

Countertrade is a serious danger because of the continued transfer of technology and the loss of production and jobs. Yet countertrade may represent 20 percent of world trade in the 1980's.

Critical U.S. military technologies have been handed over to nations committed to support the Soviet Union as part of a massive pattern of transferring U. S. technology around the world.

The AFL-CIO has long urged adequate monitoring of nonmarket trade and bilateral regulation.

Services represent a huge combination of issues too long overlooked in trade policy. For U.S. banks, shipping companies, airlines, broadcasting, advertising, insurance, and many other types of firms, the policy issues seem clear: Discrimination against their foreign expansion calls for action by the U.S. Government.

For many years, AFL-CIO policies have also called attention to effects at home. Seven out of ten United States jobs are now in services.

American seamen were the first to experience the export of service jobs after World War II.

American air traffic has led to disputes that affect pilots, flight attendants, and maintenance crews.

The AFL-CIO does not want to see jobs in services—now the majority of jobs in the United States—traded away as manufacturing jobs have been.

In the new world of services, definitions are needed. The balance of payments accounting lists "services" or "invisibles" to include current payments for virtually everything except merchandise and long-term capital flows. Such a massive bundle of industries and problems is a tall order for the world's negotiators.

The AFL-CIO believes that policies on services should be carefully developed on a case-by-case basis to solve specific situations. Action to solve these specific cases should be undertaken on a bilateral basis.

Long-term policy goals for multilateral negotiations should not get in the way of solutions for present services problems.

The long-term trends indicate that investment abroad has grown so much that the policies to expand it are obsolete.

Services are therefore intertwined with the massive increases of total U.S. international capital flows. These rose 800 percent between 1970 and 1980 and dwarf the 164.5 percent increase in the Nation's gross national product. These capital movements are highly volatile and interfere with domestic economic stability.

Flows of U.S. direct investment abroad were $7.6 billion in 1970 and $24 billion in 1979—an increase of over 200 percent.

In comparision, fixed nonresidential investment in the United States rose only 169 percent during this period.

While it remains at lower levels, foreign dirct investment in the United States has increased at even a faster rate than U.S. investment abroad.

Between 1970 and 1980, annual foreign direct investment in the United States rose more than sevenfold, from $1.4 billion to $10.9 billion.

Floating exchange rates have weakened U.S. trading relationships by causing unnecessary fluctuation in expectations, unsettling markets, adding to investment abroad and leading to more inflation at home. They have encouraged high interest policies at home that to a large degree "manage the float."

The policy of using high interest rates to curb inflation at home has a double impact on the United States. Such rates hurt U.S. investment and also hurt chances for improvement of industries adversely impacted by imports.

In the first 10 days of June 1981, the U.S. automobile industry had its lowest sales in 20 years and tight money as well as imports were the major cause.

High interest rates attract short-run, unstable capital from abroad. The dependence on high interest, restrictive monetary policy weakens the United States and hurts the ability of the traders to improve the domestic economy.

Thus, the AFL-CIO priority in attacking inflation is to attack its main underlying factors—high interest rates, too much dependence on imported oil, obsolete productive capacity, poor income distribution, and unemployment.

The maintenance of high interest rates to attract massive capital inflows is doubly self-defeating.

The AFL-CIO has joined trade unions in Western Europe and other industrial countries in urging our governments to seek steps to promote full employment, price stability, investment, and adequate growth while coping with energy needs and technological change.

The AFL-CIO believes that more realistic and effective U.S. policies should lead to a greater cooperation with other countries for more efficient and effective trading systems for mutual benefit.

Foreign policy will always affect this Nation's policies on trade. But successful foreign policy requires that the United States maintain its prowess at home and not assume that this economy can adjust to every foreign policy change with public explanations that the United States must have free trade or foreign countries will be injured.

We believe continued failure to act to revitalize the U.S. economy will injure other economies as much as our own.

Government participation in trade must therefore be recognized as an ongoing reality—not something to be avoided at all costs.

Under the U.S. Constitution, Congress is empowered to regulate interstate and foreign commerce, to levy taxes, et cetera.

The President conducts foreign policy. Both have a responsibility for a trade policy that helps the Nation at home as well as abroad.

Instead there has been an abdication of responsibility. The major decisions have been to avoid taking necessary actions to revitalize the U.S. economy while talking about free trade in a world where free trade no longer has meaning.

The United States needs a fair trade policy in keeping with the world of the 1980's. International trade decisions at home must stress the U.S. need for a diversified industrial base with the skills and services of an advanced economy. Only a policy to create full employment and rising living standards at home will enable the United States to maintain its cooperative role as a leader in the world.

Thank you.

Senator HEINZ. Mr. Kirkland, thank you for a very comprehensive statement.

You have pointed out the need to look at the world as it is; to be realistic about it. Last week, we had six representatives from the administration in. You may have had a chance to review some of their testimony.

Do you believe the administration views the world as it is realistically, when it comes to trade?

Mr. KIRKLAND. Well, sir, my impression, based upon the so-called white paper and the positions that are taken, is that they view the world as it appears in the book but not as it is.

Senator HEINZ. You point out that in 9 of some 45 cases, industries petitioning under section 201 have received some, but by no means necessarily all of the escape clause relief that they are legally entitled to seek.

Now that suggests that either the ITC is making terrible decisions—you note that they, in almost every instance, grant less relief than the industry seeking relief has requested—or that the executive branch is abusing the discretion that it is granted in section 201.

Do you believe that Congress should further restrict the discretion of the executive branch to waive or substantially modify 201 recommendations?

Mr. **Kirkland**. I would say based on the record, sir, that would be in order. The law sets out the policy. The law provides channels of relief in cases of injury.

The law was signed by the President of the United States. The purposes of the law have been by and large flouted, watered down, or ignored.

Senator **Heinz**. Do you think that Presidential discretion should be simply eliminated or would you favor giving him much tighter constraints in order to waive any of the recommendations, such as making explicit certain foreign policy considerations that might enter in?

Mr. **Kirkland**. Well, sir, I have not thought about that in detail as to what the specific modifications regarding Presidential discretion might be.

I would say as a beginning, that when an approach such as that enunciated in the so-called white paper is being put forward, it goes against the grain, as I have said, of the principles of basic law now in place.

As a beginning, I think the administration owes it to the people of this country, to the communities of this country, to define the consequences. I think they ought to tell all of the workers in those industries that are going to be adversely affected how many jobs they are going to lose, who will be hurt.

They ought to tell the communities of this country which ones of them are going to be devastated by the loss of an industry on which they depend.

I think that the public ought to be entitled to all of the facts, all of the consequences and be given the most probable projections of what this policy that will lead to.

Senator **Heinz**. Now one of the characterizations of that policy that was made last week, was "survival of the fittest." Have you estimated what that policy will cost in the way of jobs unless we insist on some of the things you suggest, such as reciprocity?

Mr. **Kirkland**. Well, social Darwinism is I think what that used to be called, "survival of the fittest," when applied to economic policy. It had a good run in this country. It is not new. It had its heyday during the period of the Robber Barons, at the turn of the century, I believe. It was taken as basic truth by industry spokesmen, conservative spokesmen, their supporters in academic life.

I think it harmed the country, the people of this country a great deal. In the first place, who are the fittest? What makes them fit?

I suspect, in some cases, control of Government is one of the means of becoming fit. Getting advantages for yourself through all of the instruments of power in this country is one of the means of becoming fit.

Being fit is not a gift of the Lord. It is sometimes the product of preferential treatment in this society.

Senator **Heinz**. Well, sometimes it is, to be honest about it though, a product of success, of efficiency, of doing a common thing uncommonly well.

How can we do a better job of insisting on reciprocity with our trading partners and competitors?

Mr. **Kirkland**. We believe in the principle of reciprocity. We always have. We think reciprocity ought to be a basic element of trade policy.

But, it requires hard negotiations and it requires a capacity to respond in kind in the face of discrimination and restrictions on our products overseas. It requires hard bargaining.

I don't believe that putting your cards face up on the table, as in the case of this white paper and saying, "You are not going to do anything about it," if there is discrimination against you, that you hold this abstract slogan higher than the realities of the circumstance is not, I think, conducive to the kind of bargaining that you are going to need to effect reciprocity.

Senator **Heinz**. If you turn your cards up in a poker game before the showdown, it does give the fellow you are betting against kind of an advantage.

Mr. **Kirkland**. Somewhat. I would be happy to——

Senator **Heinz**. I would love to play something like that.

Mr. **Kirkland**. Yes, sir.

Senator **Heinz**. My time has expired. Thank you, Mr. Kirkland. Senator Danforth.

Senator **Danforth**. Thank you, Mr. Chairman.

Mr. Kirkland, whereas the administration's white paper was characterized as survival of the fittest, your statement would appear to me to be one of "Well, we can't compete. Let's just give up."

Would you accept that characterization?

Mr. **Kirkland**. No, sir.

Senator **Danforth**. It seems to me that protectionism is the theme of every point in your testimony, that this position is 180 degrees away from the administration's position and that your view is that we have had it and should just adopt a fortress America position, not try to compete, and should keep other products out to the best of our ability. Moreover, we should recognize that the real world is a world where free trade isn't possible, and therefore, we should not only try to limit imports and protect American jobs, but be very restrictive with respect to U.S. investment abroad.

Have I missed the point of the paper?

Mr. **Kirkland**. Yes, sir.

Senator **Danforth**. Or your testimony?

Mr. **Kirkland**. Yes, sir. I don't subscribe to that characterization at all. What I was saying basically is that if you are playing basketball and the rest of the world is playing soccer, you are going to lose.

We either have to play the same game or bring them to the same rules that we apply.

I believe in the principles of comparative advantage. I believe in the flow of goods in world commerce according to the most economical point of production and the most rewarding, for both sides, terms of trade.

But, I believe, sir, that the world as it is tilts the scale. That comparative advantage as it now exists is not a product of natural forces. I wish that it were. It is the product of policies.

A very great part of the world, for example, sir, does not have anything that even remotely resembling or even claim to be a free economy, a market economy.

Most of the countries of the world have to some degree or another, managed economies. A great deal of the world has state monopolies.

How one can apply the principles of classical free trade and comparative advantage to a world where commerce is to a very large extent managed by controlled economies or state monopolies, is beyond me, sir.

Senator DANFORTH. Well, this isn't new though, is it? I mean, the fact the rest of the world has managed economies. Controlled economies is not a new phenomenon, and yet, it is my understanding that the position of the AFL–CIO, say a decade ago, was essentially a free trade position.

Why the change, if there has been a change, why the change in the policies of the union?

Mr. KIRKLAND. Well, you might ask the same of both sides to these arguments, sir. It is true that in the 1930's and 1940's, we supported the Reciprocal Trade Agreements Act. We believe the promises. We believe that trade from this would be opened up, would be expanded, would be beneficial to all sides. We believed in the principle of reciprocity which we still believe in.

I think that the labor movement was one of the very few forces in society that supported that principle before this Congress. I believe that most of the manufacturing spokesmen at that time opposed it.

I believe that there has been a lot of changes in positions, and I think they have been brought about by certain realities.

In the case of the AFL–CIO, I can testify to you, sir, that we clung to the ideals of reciprocity, expanding trade and goods and services long after, long after our membership had departed from it, because of their presence in the cockpit, because they were the ones that were the first victims on the line of battle and were losing their jobs.

We went through a period where practically every union meeting or convention the resolutions regarding trade problems were the most hotly argued and the most ardently pursued.

Yes, we followed our membership, sir. We followed our membership who saw what was happening to them and saw that, in terms of this proposition, it worked practical injury to them, to their families, and to their communities.

We reached a commonsense conclusion, sir, that there must be something wrong with this. It isn't working according to theory. The fact is that we were exporting not goods produced here, but we were exporting the means of production. We were exporting comparative advantage in many cases because autarchic or mercantilistic practices, if you will, by the rest of the world.

I would submit that the record and the facts show that the prevailing made is mercantilism and autarchy and not classical free trade.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator HEINZ. Senator Long.

Senator LONG. I think I agree with the general thrust of your statement, Mr. Kirkland. If your economists have not put some attention to it, I would urge that they should immediately look at Mr. Wiedenbaum's statement, the Chairman of the Council of Economic Advisers. He appeared earlier in these hearings.

He presented us a bunch of facts and figures which disturb me. According to Mr. Wiedenbaum's statement—it sounds like they must have sent an audience of agitators to shout me down.

According to Wiedenbaum's figures, last year we had exports of $339.8 billion, roughly $340 billion; imports, $316.5 billion, for a surplus of $23.3 billion.

So, according to Mr. Wiedenbaum's figures, we made a profit of $23 billion in the trade of goods and services which would indicate that we are obtaining cheaper goods and cheaper services by virtue of foreign trade and making a big profit at it.

Now, I have tried to get a breakdown of how he arrived at that. Those figures, incidentally, were provided by the Department of Commerce to the Council of Economic Advisers.

I asked them to give us, to get a breakdown on that. Well, we find in those figures he was putting exports in of goods, at $220 billion; imports at $225 billion, for a deficit of $25 billion in goods and services.

Now, we made it against the law for them to use those figures unless they first gave us the figures the way we thought they were honest, where you would include the insurance and freight just like everybody else does, on your imports.

So, when you do that, that changes the figures by $11 billion. That means on a CIF basis, in terms of goods, imports and exports, we had a deficit of $36 billion.

Now that is $11 billion that the Commerce Department would leave out and Mr. Wiedenbaum would leave out, but we by law, made them put it in. We just said we think that is dishonest bookkeeping.

So, by act of Congress, we had to fight this matter over 10 years to finally win that fight, to make them keep these commodity trade figures honestly.

Then I asked him to get us the other figures. So he said we have exports, profit on return on foreign investment of $75.9 billion; imports, $43 billion, or a surplus there of $32.8 billion.

I don't know about that. I would assume basically that the argument here is that somebody over here is making a profit out of exporting American jobs.

You know, you were talking about the merchant marine. Some of these foreign countries have a lot of Americans invest in their merchant marine, a lot of money going over there, American money, to man the ships that some of us would like to see manned by American sailors.

Mr. KIRKLAND. How big a fleet flies under the Liberian flag?

Senator LONG. Yes. Now some of those countries make it against the law for any of their shipping companies to reveal anything to us about any of that. This Government and its trade policies on maritime affairs is doing business in such a way that Americans are making a lot of money out of putting Americans on the beach rather than on the ships.

That type of a thing I think your people ought to look at so you could help advise me what all this means. I suspect that some of that great good news about some Americans making a lot of money out of Americans losing their jobs, which wouldn't set too well with people in your line of endeavor, trying to represent the American workers.

This other item in Mr. Wiedenbaum's figures "true services and military", we are supposed to be showing a surplus of $15 billion. Now how they are making a surplus out of that, I would like to know more about it.

But, part of your problem, and I think part of this Nation's problem has to do with people making a lot of money out of some of this thing, which is not good for Americans.

I suspect you would find that some of these so-called returns on investments we are making is in foreign countries, where their laws won't even let them bring that money home. It has to stay over there for their benefit, rather than come in here for our benefit.

Do you have some people working on studying this type of a thing, this type presentation being made to these committees?

Mr. KIRKLAND. I trust so, sir. We have Ms. Jaeger working very hard and doing good work, I think. She may have a comment on it.

Ms. JAEGER. Yes, I think Senator Long that the problems of presenting the data are very severe because effectively, the reporting that you are talking about, about cost, and freight insurance in trade, is a fight that most of the macroeconomists have not really ever understood and therefore they haven't accepted.

It takes a long time for people who have not worked in the field to understand why it is important to report CIF the way that Congress has established it.

It is too bad that they continue to use both sets of numbers, because, in effect, you get two different answers every time.

I think also that return on investment point you made is one that is long overlooked, because people don't understand that services include dividend returns on the balance of payments bookkeeping. That is why it is so confusing.

But, as long as it is confusing, they can just say that free trade will help us. I think it is very useful to call attention to the fact that the figures can be interpreted different ways and the different kinds of statistics are used for different purposes and the public is left with a sense of mystery that should not be a mystery because they should get a fair accounting. We do work on it, sir.

Senator LONG. My time is expired. I just want, if I might be permitted, just make this comment. It is my impression that those who are engaged in policies which are contrary to the interests of the working people and contrary to the interests of the Nation as a whole, invariably try to make the thing so complicated that nobody can figure it out for very obvious reasons.

If people understood what this is all about they wouldn't stand for it. I think there is a great deal of merit to what you are saying here, a great deal more merit in your position than in Mr. Wiedenbaum's statement that everything is just great, which indicates we ought to do more of the same.

Mr. **Kirkland**. Senator, the point that you have been making, I think underscore, a basic proposition that has a great deal to do with this argument. It is a fact that capital, money, investment, has great mobility. It can accommodate itself to almost any system.

It accommodates itself to communism. It accommodates itself to socialism. It accommodates itself to protectionism. It can leap barriers. If another country puts up barriers, it can leap those barriers and work behind those fences and take advantage of those fences by locating in that country and complying with that system.

It can engage in joint ventures with slave societies like the Soviet Union that have nothing whatever to do with anything that is in the classical textbooks. It can arrange its affairs to suit any situation and profit from it. The workers can't. They are left behind. They stay behind. The American communities can't, they stay behind.

I suggest to you sir, that does create a little difference in perception between those who are not so mobile and have to endure the consequences and those who control the fluid and free-flowing capital and the free-flowing consciences and the free-flowing shifting politics and those in academic life whose careers are essentially based on serving them.

Senator **Long**. Thank you.

Senator **Heinz**. Senator Bentsen.

Senator **Bentsen**. Thank you very much, Mr. Chairman. President Kirkland, we are glad to have you with us this morning.

In thinking about your comments on international trade, I agree that the United States has been wearing kid gloves. The international trading market has been dominated by brass knuckles. We haven't recognized that.

I agree with you that any time we talk about true reciprocity in this country, all kinds of columnists throw up their hands and say, "That is protectionism."

All we want to do is see that we have true reciprocity.

The problem of developing trade and exports for us is going to be even more demanding and more important than it will be for most of our trading partners in the countries of Europe, for example.

Most of them have a birth rate that is either stable or declining. But our statistics indicate that, we will have to create 15 million new jobs in this country.

That is why it is imperative to increase our exports.

We can think of so many examples. I think of the helicoptors in my own State. The Department of Transportation sought to buy 90 helicoptors and had a U.S. firm bidding—U.S. workers, U.S. components—against a French company that was a shell with a $300,000 capital surplus, and owned by the French Government. As I recall, the bids were less than $2 million apart. However, the contract was awarded to the French company who didn't have the problems we have. Their stockholders profited because a French Government owned company could underbid the U.S. firm as a matter of Government policy.

I am concerned about your examples regarding television. A complaint filed under section 201 on imports took almost 20 years before being resolved. By that time, the Japanese totally dominated the market.

You have the same kind of a problem with section 301, regarding exports.

The Japanese run page ads in the Washington Post, for example, bothering the Congress. I wish we could run page ads in Tokyo. All I would list would be the products, what the sales price was on that product in Tokyo and what it was in the United States. I would list Japanese products and I would list U.S. products.

I would show the great disparity between what our products sell for in our country and what they sell for in Tokyo. Yet, their products sell for the same price in both countries.

Those are the things I think ought to be emphasized in this country.

Now, with that as background and given the fact that the American workers are still the most productive in the world—despite aging equipment—what improvements in section 201 and section 301, on both imports and exports, might we make that would enable us to react faster and get more meaningful decisions?

Mr. KIRKLAND. Well, sir, I would start with a little observation that we need not await change in the legislation, although there are many ways in which it might be improved. From time to time we have supported legislation that has been before the Congress to do that.

But it would be a great help if the principles in the law were seriously followed; that is, where there is a showing of injury and we have indicated in our testimony that the capacity to establish the facts necessary to a showing of injury ought to be greatly improved through monitoring, and so forth.

And a little more concern for the realities on the part of the ITC. Once the ITC has acted, support from the President.

Senator BENTSEN. Well, it is very frustrating for those of us on this committee. I think all of us probably supported the shortening of the time period on section 301 to try to bring about an earlier decision.

I, at least, haven't seen the results yet.

Mr. KIRKLAND. Yes.

Senator BENTSEN. Do you think it is a matter of being better informed and trying to effect just decisions that reflect what is actually happening?

Mr. KIRKLAND. Oh, I think there could be a number of improvements there, but the law as it now stands, if there is an injury or a serious threat of injury, the industry is entitled to relief. There is a forum to which they ought to be able to go and to get it.

Yet, in the majority of cases, that path is blocked and frustrated, as you say, for extraordinary periods of time and at the end of the line they are thwarted by the contrary policy on the part of the people with the ultimate authority.

Senator BENTSEN. President Kirkland, I certainly support free trade. But, as you say, it ought to be reciprocal. We should be able to react quickly when we see subsidies and when we see dumping, but we are just not doing that.

My time is expired. Thank you very much.

Mr. KIRKLAND. Thank you, Senator Bentsen.

Senator HEINZ. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Kirkland, on page 2, you say "Monitor imports and exports and their impact on the U.S. economy. Such detailed monitoring is required now, but does not exist."

You refer then, on page 4, to fabricated steel as an example of this.

Precisely what kind of statistics would you want kept to have a satisfactory picture available to Congress and to the public?

Mr. **KIRKLAND**. Well, if you don't mind, Senator, I would like to turn to my capable adviser here who knows far more than I do about this thing.

Senator **PROXMIRE**. Very good.

Ms. **JAEGER**. In the latest budget revision it is my understanding that the budget has been cut so that there is very little inspection now of goods that are coming in to the country.

Consequently, what you are dealing with because the decision has been made to transfer everything to computer tape, is far less recognition of what the product is than of the reports of the dollars that are flowing back and forth.

All you are getting, really, is a reporting in a sense of computer tape rather than the actual product.

Let me give you an example. If you get a great many different kinds of nuts, bolts, and screws, they may have a great many different implications for American industry. They may be produced by very many different types of producers, but all you are going to get on the reporting is what they call a basket category, and therefore, that basket category will simply have a dollar value.

You won't have any idea what is coming into the country or its impact on a great many parts of the community.

Senator **PROXMIRE**. Could you give us this in detail, for the record?

Ms. **JAEGER**. Yes, sir.

Senator **PROXMIRE**. It will be very helpful.

Ms. **JAEGER**. Yes, sir.

[Material was subsequently supplied.]

INFORMATION ON MONITORING IMPORTS

Although many statutes require import monitoring for effective implementation, adequate information is not available to determine the impact of imports on production and jobs in the United States.

For example, many types of fabricated steel are not monitored. One reason is that so many types of products, such as different types of fabricated steel are lumped together in one tariff classification: the Tariff Schedules of the United States has a general category of bridges, bridge sections, lock gates, towers, lattice masts, roofs, roofing, door and window frames, shutters, balustrades, columns, pillars and posts and other structures. These are designated by very few different tariff schedule items. "Offshore oil and natural gas drilling production platforms and parts thereof" are a single tariff schedule item. If detailed statistics are not maintained on these items, then import injury can occur, but cannot be proved. Without documentation, policymakers do not have a sense of the size of the problems

Auto parts are another good example. One reason that small business cannot make an effective case on injury from imports of auto parts is that there are no statistics available on imports of many individual parts.

The Customs Service, which is responsible for providing the initial data on imports, has been affected by budget cuts. In addition, the Customs Service changed its regulations so that fewer goods would be inspected. Their emphasis is on spurring trade and not on assuring adequate help to U.S. consumers, producers and workers. Consumer protection and safety laws are ineffective when enough import specialists to inspect hazardous goods or check on import classifications are not available. (See attached letter from Rudy Oswald to Commissioner of Customs.)

The Congress has repeatedly called for adequate monitoring and statistical reporting, but neither the funding nor the implementation by the Executive Branch has made adequate data or adequate monitoring a reality. The 1982 budget reduced authority actions for monitoring while trade continues to expand.

DECEMBER 18, 1980.

Mr. ROBERT E. CHASEN,
Commissioner of Customs,
U.S. Customs Service, Washington, D.C.

DEAR MR. CHASEN: The AFL-CIO urges that you rescind Customs Manual Supplement 3600-04 dated June 11, 1980. This proposal would end effective inspection of imported commodities by trained personnel who are able to make decisions and informed judgments about which materials comply with the law. Such specialists are expert in their understanding of hazardous substances and other commodities whose importation in regulated by law.

We believe that the U.S. customs service has a responsibility to assure that U.S. laws are observed. The release of unsafe components into the stream of commerce because of inadequate customs supervision is, in our view, a direct contradiction of the Congressional mandate to the customs service to carry out the laws that affect imports. Commodities also need to be subject to inspection to assure compliance with other trade laws.

Consumers who have relied on the customs' control of potentially hazardous substances as well as other unsafe items, will face increased risk if certain goods are not inspected by competent customs experts.

Sincerely,

RUDY OSWALD, *Director.*

Ms. **JAEGER**. I wanted to mention one point though, in terms of fabricated steel. I think it is important that people believe the steel industry is now being protected by the trigger price system. But the trigger price system does not apply to fabricated steel and the kind of monitoring that is applied to other steel products might be very useful for more products.

Thank you.

Senator **PROXMIRE**. Very good.

Then, on page 3, you say "And the incentives U.S. firms now have to invest abroad in order to take advantage of multibillion dollar tax subsidies and insurance for overseas investment."

I run into this all the time, Mr. Kirkland, in my State. People are always complaining about that. I think you have a very good, strong point that is widely supported in the country.

But, specifically, what kind of tax changes are you recommending?

Mr. **KIRKLAND**. We have recommended, sir, the termination of DISC.

We have recommended, and I think have supported legislation for this body to terminate the overseas tax credit and the deferral of overseas earnings and taxes.

Senator **PROXMIRE**. Very good. Well, I support those proposals. I think they make sense.

Now then, the following paragraph, you say, "Repeal counterproductive laws." And you say, "For example, the United States now grants zero tariffs or preferences for imports for more than 2,700 products from 140 nations and territories."

You provide this only apparently for the neediest countries and not for other countries; is that right?

Mr. **KIRKLAND**. That is correct, sir.

Senator **PROXMIRE**. Wouldn't this be pretty much of a clear reversal of what attempts we have to promote free trade?

Wouldn't this be a signal? Wouldn't it be clear under these circumstances that we would have, if we revoked 2,700 products from 140 nations, wouldn't this mean we would have higher tariffs, higher prices, less competition from abroad, more inflation?

Mr. **Kirkland**. I don't think so, necessarily, sir. I don't believe that the fact that the item produced, shoes, for example, at lower labor costs overseas, that that is reflective necessarily in the market retail price in this country.

I have seen many products that are made overseas that are exorbitantly priced in this country that can be produced in this country at a profit, a reasonable profit.

But the fact is that the retailer gets a bigger markup, the wholesaler gets a bigger markup, because the end product still ends up at the U.S. market price regardless where it is made and regardless what the cost was. There is a bigger markup granted on the products that come into this country more cheaply.

But the consumer, a shirt produced in this country and a shirt produced in Hong Kong under the same label will cost you the same.

I believe sir, well, I have seen the so-called $4 Korean shoes. They are really two pieces of plastic tacked together like shower slippers selling for $3 or $4 in a discount drugstore.

Those could be produced in this country at a very substantial profit for that retail price, not as big a profit as you can make by bringing them in from over there. But I don't believe the consumer ultimately gets that much of a break.

Beyond that, beyond that, to speak of free trade and with the systems, elaborate systems of preferential treatment for firms that locate there, to entice firms to locate there, for example, assurances that they won't be troubled by trade unions or by safety standards or by minimum standards of health and decency, by minimum wages or hours, that they won't pay sales taxes, that they won't pay the taxes on the products that they bring in for use in the fabrication of the product.

They would get free land. They would get all sorts of privileged treatment from the Government in order to establish these productive facilities, to compete back in the American market.

Well, if that is what free trade means, I don't think you find it in any textbook that explains the theory of comparative advantage, sir.

I would feel a great deal differently about this issue of the broadside universal granting of zero tariffs if those countries would adhere to certain minimum standards as far as the conditions of life and labor are concerned.

If they would adhere, for example, to the standards of the international labor organizations regarding health, safety, and working conditions, not American standards, but some generally approved norm. In fact, most of these countries have ratified the conventions that theoretically obligate them to observe those standards and they disregard them. They disregard them.

We should have them incorporated within this concept of zero tariff and the generalized system of preferences in order to elevate conditions of the developing world. I would at least like to see it conditioned on observance of the minimum labor standards which they have ratified, as set forth by the ILO which they have embraced and for which they vote at every ILO conference.

That at least would give us some little assurance that some of the benefits of these accommodations and these policies that are designed to help them develop, that they would spread to the general population and not simply go to the elite in those countries, then I would feel far more favorably disposed.

I would see nothing wrong in confining it, for example, to those countries that do in fact practice those minimum laws and provisions in terms of health, safety, and decency that they have internationally obligated themselves to.

Senator **Proxmire**. Thank you very much.

Thank you, Mr. Chairman.

Senator **Heinz**. Senator Long.

Senator **Long**. I just wanted to touch on one other subject. I asked the last previous witnesses, what is the tax component on imports coming into this country and what is the tax component on our exports?

Now as important as that matter is, it always amazes me to hear the administration would come up here and plead ignorance.

I know the Special Trade Representative, Mr. Brock, says, well, if you want to put it on that basis and recognize in effect that foreign countries find ways of rebating almost all the taxes that are collected over there, at the border when they export it, then there is not much difference.

They have value-added taxes all over Europe, for example. They give taxes back when goods produced are exported. We ship in their direction, they meet us at the border with a border tax to add it on top of the taxes that have already been paid here. I don't know of any tax we are rebating at our border.

It looks to me as if the tax component of our exports has to be 20 percent or more. I can't see that we are rebating any of it or very little, if any.

If so, I would think that is something we ought to be thinking about. What I would be curious to know, one, what is your estimate of what the tax component is on our imports and what if anything you think we ought to try to do about that.

Mr. **Kirkland**. Well, sir, I think you put your finger on one of the practices that makes a farce of theory. I don't know if we can quantify the total effect on tax tilting of the terms of trade, but I think it can be clearly seen in specific cases. The United Kingdom has, and most of Europe, I think, has a 15-percent VAT which is forgiven for exports and imposed on imports from the United States.

Well, that is a pretty big net swing. I think at those dimensions, it can profoundly affect the flow of trade and it is a practice that I think warrants the term "protectionism" far more than anything we have suggested.

Senator **Long**. Thank you.

Senator **Heinz**. Senator Bentsen.

Senator **Bentsen**. Thank you, Mr. Chairman.

Mr. Kirkland, I happen to support a general system of preferences and feel it is important we try to help some of the lesser developed countries.

I am concerned about the fact that 70 percent of the GSP goes to five countries—Korea, Taiwan, Brazil, Mexico, and Hong Kong.

Some of my colleagues have proposed legislation to try to shift some of that trade to some of the countries that are even less developed than these five, feeling that these, in some instances, have come along rather well.

I must say with some bias, I don't think that these changes should apply to Mexico because they are of such importance to us as a neighbor and our trade is pretty well in balance. We share a rather good relationship on trade.

Have you given any thought to the objective of trying to shift via legislation, to some of those countries that are even needier?

Mr. **Kirkland**. Yes, sir. We would in fact, as I indicated in my statement, we would first of all favor the elimination of the across-the-board generalized system of preferences, which of course, leaves room for the negotiation of any set of arrangements bilaterally with countries that the foreign policy considerations, considerations of humanitarism or enlightened international policy that we might wish to provide with special breaks.

But I don't think the program which treats all alike when they are not alike makes sense, particularly at a time sir, particularly in the absence of any consideration at all as to whether or not these countries have decent standards of work life or human life, whether in terms of the degree of freedom they afford their citizens or the conditions under which they labor. We think the social clause or a clause relating to minimum standards ought to be a factor included as a condition for zero tariffs.

That is called for particularly at a time when we have been, very properly, in a sense long overdue, requiring our manufacturers to live up to certain higher standards of safety and health and pollution, environmental impact and so forth.

It is all too easy for them to escape those requirements, move to another country where they don't exist, and then reexport back to this market with a zero tariff, after they move there in order to escape minimum standards of decency, health, and safety.

They go to another country and kill those people instead of Americans. For that, we give them a zero tariff.

Senator **Bentsen**. Thank you.

Senator **Heinz**. Mr. Kirkland, thank you very much.

Mr. **Kirkland**. Thank you, sir.

Senator **Heinz**. Thank you. It is always good to see you.

[Statement of Lane Kirkland follows:]

STATEMENT OF LANE KIRKLAND, PRESIDENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ON U.S. TRADE POLICY BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE COMMITTEE ON FINANCE AND SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY OF THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, UNITED STATES SENATE

July 13, 1981

The AFL-CIO believes the United States needs a modern trade policy. As the U.S. trades with more than 150 nations and territories, imports and exports of products will be worth more than one-half trillion dollars this year. This trade will have a substantial impact on jobs, technology, investment and the industrial destiny of this nation. Policies to deal with the price to our nation as well as the benefits of this enormous trade expansion should be restructured in a comprehensive, realistic and fair manner. It is time for this change.

The AFL-CIO has heard the explanations for trade policy come full circle since World War II. As U.S. seamen watched the shipping industry decline and their jobs go to foreign flags, they were told that the U.S. is not a service nation but a manufacturing nation and that exports of manufactures create jobs. However, in the three postwar decades, various types of manufactures went into deficit: textiles, steel, shoes, autos, electronics and some kinds of machinery. Each time, exports of a higher technology product was given as the "answer." But the lost steel plants in Pennsylvania, autos in New Jersey, railroad parts in California, shoes and machinery in Missouri, and electronics, glass, rubber and aluminum nationwide left expensive scars. Increasingly, huge imports of parts were a major factor even in aircraft and computer sales. So the dollar sign on export sales no longer always added up to jobs. In fact, in 1980 the U.S. trade balance shifted from a surplus to a deficit of $32 billion. By 1981 the story is, "We must emphasize service industries in trade policy, because the U.S. is a service economy."

No such easy answers will solve complex problems:

The AFL-CIO believes the United States must be a diversified manufacturing, agricultural and service economy, with the full complement of technological industries. Anything less is a failure to develop the resources and industries this nation can provide for full employment and rising living standards. Trade is part of that goal -- not the other way around.

A fair trade policy can help build that goal. A policy of government abdication of responsibility in the name of free trade can make the losses from trade much higher than the gains for most Americans.

A fair U.S. trade policy would:

* provide a full account of what happens in the real world, a world where free trade does not exist. Other nations in the world do not apologize for pursuing their national interest. Yet the U.S. is under constant assault when suggestions are made to move in U.S. national interest.

* enforce U.S. laws and international agreements against unfair trade practices so as to allow U.S. producers and workers a chance to improve industries impacted by trade. Procedures that now inhibit appropriate responses should be simplified.

* monitor imports and exports and their impact on the U.S. economy. Such detailed monitoring is required now, but it does not exist. Without such monitoring, industries and workers now injured

by imports are not able to make their case and solutions are not provided.

* achieve reciprocity. Where other nations bar U.S. products through one means or another, the opportunity to enforce U.S. laws to gain access should be encouraged to even out the burdens in the world. Equivalent access to foreign markets is key.

* end the incentives U.S. firms now have to invest abroad in order to take advantage of multibillion dollar tax subsidies and insurance for overseas investment. Firms that go abroad for cheaper labor should not be given subsidies to do so. These subsidies and pressures for expansion or relocation abroad should be repealed.

* repeal counterproductive laws. For example, the U.S. now grants zero tariffs or preferences for imports of more than 2700 products from 140 nations and territories. These special privileges, called the Generalized System of Preferences (GSP), do not aid the neediest people abroad, and the imports injure U.S. industries and jobs. This Generalized System of Preferences should be repealed. At a bare minimum, Congress and the Administration should remove import-sensitive products from the list, guarantee that only the neediest countries receive the benefits, and exclude communist economies.

* establish national security policy goals that provide not only an adequate defense but also a fully-employed, strong economy. Only a strong United States that has the means to feed, house, clothe and transport its population can provide adequate national security.

* provide realistic adjustment assistance for those injured by trade. The cost to the nation of losing its pool of skills is severe. Millions of Americans have lost their jobs through no

fault of their own as a result of trade policies. Lost jobs, devastated communities and eroded tax bases dot the U.S. landscape. Yet these losses are not even measured, much less corrected.

Discussions of world trade barriers in Washington in 1981 lead the uninformed observer to believe the United States has many barriers to trade and the world has very few. The facts are the reverse. The world's economies have planning, import regulations of all kinds, export requirements and export subsidies, as well as requirements to produce within their borders. No such protection exists for U.S. industry, which only can move abroad and/or become importers. Much of U.S. industry already has moved. That is not fair.

Most nations of the world have content requirements or special requirements in law or practice that require companies to produce within national borders or to make a certain percentage of the content of a product, such as a car, or a machine in that country. The U.S. needs to adopt such content laws for essential industries or it will become an assembler of foreign-made parts. Other performance requirements may need special actions. Export requirements, for example, can be met by withdrawal of U.S. privileges to other countries under current law.

Attempts to carry out international agreements or other pursuits of U.S. rights are regarded as protectionism -- but little attention is paid to actions of other nations against the U.S. and to constant barriers to U.S. exports. That is not fair.

Enforcement of existing laws -- and improvement where they are failing -- is therefore a first step toward fair trade. Subsidies, dumping and other unfair trade practices, condemned in law -- both nationally and internationally -- have received relatively little effective action. Even when injury is proven and violation of laws and agreements is well known, only occasional limited actions have been taken.

For example, steel has been subsidized and dumped in the U.S. market for a long time. But neither the U.S. law on dumping nor the international agreement has been widely enforced. A "trigger price mechanism" to get the steel industry to withdraw its dumping suits was established and was helpful for a time. But the massive losses of American steel production continue in many products. Fabricated steel is not even monitored, so that loss is uncounted.

A U.S. petition for dumping action on imported TV sets received a positive finding in the late 1960s. However, legal suits continued until June 1981 when the ITC ruled against the Japanese attempt to reverse earlier decisions. These U.S. actions were too little, too late, and in the meantime, the industry has been eroded.

The auto workers and many other U.S. unions petitioned for relief from auto imports -- injury that was obvious. The law designed to provide time for the industry to become competitive is Section 201 of the Trade Act of 1974 -- and the "escape clause" of the General Agreement on Tariffs and Trade (GATT). Thus the case was not a violation of any agreement or law. But the result was no action by the U.S. government because American opinionmakers and policymakers did not want to grant relief. Two Presidents told the Japanese there would be no restraints by the U.S. government. The Japanese when finally convinced that some action had to be taken, put modest restraints on their exports. But U.S. producers of auto parts have received no help at all for their special problems.

No injured industry has ever achieved the relief it sought under Section 201. Since the 1974 Act was passed, only 9 of 45 cases have received any action on imports. The ITC usually recommends less than industry seeks -- be it quotas or tariffs or tariff quotas -- and the President either ignores the ITC recommendation altogether or grants less than it calls for.

Specialty steel, color TVs and shoes are examples of the industries where relief has been phased out or phased down. Industrial fasteners -- nuts, bolts and screws -- received minimal relief and are currently seeking an extension.

These are just a few examples of major industries that are affected. Small producers of parts essential to these industries usually get no relief at all.

Under current procedures, the cost, the data requirements and the complex legalisms are so difficult to overcome that injured industries and groups of workers cannot afford to bring actions for relief from inrushes of imports or dumping. This is not fair trade policy. This policy of inaction leads to more unfair trade. The law should be enforced, improved and emergency procedures established to prevent the outrush of key industries.

Textiles and apparel receive some help, but the barrage of complaints about this industry leads to a distortion of the size and importance of that help. It is unfair to expect the U.S. to continue to destroy its domestic textile and apparel industry and to charge the U.S. with protectionism in a protected world.

An international textile agreement -- the Multifibre Arrangement -- regulates this trade. It should be renegotiated to provide for orderly sharing of the U.S. market growth in the U.S. This is fair under international rules.

But reciprocity -- equivalency of access to markets -- is a fair trade concept that the U.S. policymakers do not consider. Thus a U.S. exporter does not have equivalent access to the markets of Japan, or Brazil or Romania or the Soviet Union or most countries in the world, but the cry of protectionism is not leveled against these foreign governments -- only against the U.S. producers who complain. Some of the newest U.S. industries, like semi-conductors and computers and aerospace, are good examples of U.S. industries that will soon be lost because our trade policy does not enforce reciprocity. Instead, the industries can go to other nations, be protected within those markets and export to the United States or third markets. U.S. policy, which tried to avoid any help to American producers in the U.S., supports subsidies to the investors abroad in most nations of the world. This is not fair.

The AFL-CIO believes that the United States needs an improved trade adjustment assistance program for workers injured by imports. Experience for the past 20 years underscores the urgency of improving benefits for those who lose their jobs from this cause. The current budget would effectively end trade adjustment assistance. The paltry sum now available in the budget amounts to another broken promise to those who pay the price of trade liberalization.

Export Policy

Export promotion should be a government priority. Exports of farm products, manufactured products and raw materials are important. AFL-CIO members work on farms and in factories and in offices and in services. They produce some of the world's most sophisticated, as well as some of the older, industrial products for export.

However, export policy is not the answer in a world where equivalency of access does not exist. Export promotion should be targeted for specific goals and should not include capital, technology and price sensitive commodities.

To reduce inflation in food, it is important to restrict the export of commodities in short supply. The world trade in grain has become so complex that the AFL-CIO believes a National Grain Board, similar to the Canadian Wheat Board, should handle foreign sales of U.S. grain. While we wish to encourage the export of coal and other materials, policy should be flexible enough to assure adequate energy supplies at home.

Export promotion should neither get priority over domestic budget needs nor be used as an excuse for blanket changes in U.S. antitrust or banking laws.

Stopping the incentives in our tax and trade laws for foreign expansion by U.S. firms and banks would help the United States to achieve both better trading arrangements and a better economy at home.

The principal traders of the world are now multinational banks, firms and governments who are often their partners. Some governments are multinational entities. The governments of many countries -- both communist and non-communist -- have become huge multinationals. Developing countries now spawn multinationals of their own. Most multinationals are no longer U.S.-based, but the U.S.-based multinationals still dominate U.S. trade. The tax and trade laws made this possible.

The multibillion dollar tax subsidies available for U.S.-based firms' operations, such as the Domestic International Sales Corporation, foreign tax credits and the deferral of taxes on overseas profits are in direct conflict with national needs, such as the availability of capital at home. No longer can they be justified as promoters of exports. They should be repealed.

The Overseas Private Investment Corporation should also be ended, since it encourages U.S. firms to invest abroad by insuring such investment against political risk.

For foreign multinationals in the United States, the AFL-CIO has urged adequate reporting. The AFL-CIO has also opposed raids or unscrupulous takeovers, and has called attention to the need to prevent takeovers in strategic industries. In addition, the current influx of investments has led to many abuses and avoidance of U.S. labor laws. The AFL-CIO has consistently warned that U.S. laws and international codes on labor should be enforced.

The impact on U.S. trade of barter arrangements can be large. Pricing policies of the firms using barter and/or of a communist country are not based on product cost as in a market system. Countertrade is a serious danger because of the continued transfer of technology and the loss of production and jobs. Yet countertrade may represent 20 percent of world trade in the 1980s.

Critical U.S. military technologies have been handed over to nations committed to support the Soviet Union as part of a massive pattern of transferring U.S. technology around the world.

The AFL-CIO has long urged adequate monitoring of non-market trade and bilateral regulation.

Services

Services represent a huge combination of issues too long overlooked in trade policy. For U.S. banks, shipping companies, airlines, broadcasting, advertising, insurance and many other types of firms, the policy issues seem clear: discrimination against their foreign expansion calls for action by the U.S. government.

For many years, AFL-CIO policies have also called attention to effects at home. Seven out of ten U.S. jobs are now in "services." American seamen were the first to experience the export of service jobs after World War II. American air traffic has led to disputes that affect pilots, flight attendants and maintenance crews. The AFL-CIO does not want to see jobs in services -- now the majority of jobs in the U.S. -- traded away as manufacturing jobs have been.

In the new world of services, definitions are needed. The balance of payments accounting lists "services" or "invisibles" to include current payments for virtually everything except merchandise and long-term capital flows. Such a massive bundle of industries and problems is a tall order for the world's negotiators.

The AFL-CIO believes that policies on services should be carefully developed on a case-by-case basis to solve specific situations. Action to solve these specific cases should be undertaken on a bilateral basis. Long-term policy goals for multilateral negotiations should not get in the way of solutions for present services problems.

Investment Policies

The long term trends indicate that investment abroad has grown so much that the policies to expand it are obsolete.

Services are therefore intertwined with the massive increases of total U.S. international capital flows. These rose 800 percent between 1970 and 1980 and dwarf the 164.5 percent increase in the nation's gross national product. These capital movements are highly volatile and interfere with domestic economic stability.

Flows of U.S. direct investment abroad were $7.6 billion in 1970 and $24 billion in 1979 -- an increase of over 200 percent. In comparison, fixed nonresidential investment in the U.S. rose only 169 percent during this period.

While it remains at lower levels, foreign direct investment in the U.S. has increased at even a faster rate than U.S. investment abroad. Between 1970 and 1980, annual foreign direct investment in the U.S. rose more than seven-fold, from $1.4 billion to $10.9 billion.

Floating exchange rates have weakened U.S. trading relationships by causing unnecessary fluctuation in expectations, unsettling markets, adding to investment abroad and leading to more inflation at home. They have encouraged high interest policies at home that to a large degree "manage the float."

The policy of using high interest rates to curb inflation at home has a double impact on the U.S. Such rates hurt U.S. investment and also hurt chances for improvement of industries adversely impacted by imports. In the first ten days of June 1981, the U.S. automobile industry had its lowest sales in 20 years and tight money as well as imports were the major cause.

High interest rates attract short-run, unstable capital from abroad. The dependence on high-interest, restrictive monetary policy weakens the U.S. and hurts the ability of the traders to improve the domestic economy.

Thus the AFL-CIO priority in attacking inflation is to attack its main underlying factors -- high interest rates, too much dependence on imported oil, obsolete productive capacity, poor income distribution and unemployment. The maintenance of high interest rates to attract massive capital inflows is doubly self-defeating.

The AFL-CIO has joined trade unions in Western Europe and other industrial countries in urging our governments to seek steps to promote full employment, price stability, investment and adequate growth while coping with energy needs and technological change.

The AFL-CIO believes that more realistic and effective U.S. policies should lead to a greater cooperation with other countries for more efficient and effective trading systems for mutual benefit.

Foreign policy will always affect this nation's policies on trade. But successful foreign policy requires that the U.S. maintain its prowess at home and not assume that this economy can adjust to every foreign policy change with public explanations that the U.S. must have free trade or foreign countries will be injured. We believe continued failure to act to revitalize the U.S. economy will injure other economies as much as our own.

Government participation in trade must therefore be recognized as an ongoing reality -- not something to be avoided at all costs. Under the U.S. Constitution, Congress is empowered to regulate interstate and foreign commerce, to levy taxes, etc.

The President conducts foreign policy. Both have a responsibility for a trade policy that helps the nation at home as well as abroad.

Instead there has been an abdication of responsibility. The major decisions have been to avoid taking necessary actions to revitalize the U.S. economy while talking about "free trade" in a world where free trade no longer has meaning.

The United States needs a fair trade policy in keeping with the world of the 1980s. International trade decisions at home must stress the U.S. need for a diversified industrial base with the skills and services of an advanced economy. Only a policy to create full employment and rising living standards at home will enable the United States to maintain its cooperative role as a leader in the world.

Senator HEINZ. Our next witness is Mr. Edmund Pratt, the Chairman of the Advisory Committee on Trade Negotiations and chief executive officer of Pfizer Chemical Co.

STATEMENT OF EDMUND T. PRATT, JR., CHIEF ADVISORY COMMITTEE ON TRADE NEGOTIATIONS AND CHIEF EXECUTIVE OFFICER, PFIZER CHEMICAL CO.

Mr. PRATT. Good morning, gentlemen. Thank you for having me here to express some thoughts about the U.S. trade and investment policy on behalf of the Emergency Committee for American Trade, known as ECAT.

Senator HEINZ. Mr. Pratt, would you pull the microphone up a little closer there.

Mr. Pratt. All right.

Senator HEINZ. Thank you, sir.

Mr. PRATT. I am chairman of ECAT which is an organization of 63 business leaders whose firms have extensive overseas business interests.

In 1980, ECAT member companies had worldwide sales of nearly $600 billion and employed over 5 million people. I am also chairman of Pfizer Inc., and recently was elected Chairman of the President's Advisory Committee on Trade Negotiation.

I have with me Bob McNeill, the executive vice-chairman of ECAT. Since you have the statement and in the interest of time, I will try to highlight it instead of reading the whole statement.

The U.S. foreign economic policies are of vital interest to ECAT members. They profoundly affect our ability to function both abroad and at home. Along with the Nation as a whole, ECAT companies have generally prospered under the U.S. historic commitment to and search for a worldwide economic order as free as possible from impediments to the International flow of goods and capital.

We ardently hope that the United States will continue its advocacy of expansionary trade policies which have served us all so well, and particularly in promoting foreign investment.

As advocates of an open international economic order, we are greatly concerned with a number of developments at home and abroad.

Paramount among them are actual and proposed unilateral or bilateral measures intended as solutions to problems that have international consequences. I would think it is sound to wager that this decade will see investment issues replacing traditional trade issues as the dominant international economic ones.

The importance of international investment to the U.S. economy is often overlooked. Official studies and private estimates show that from one-third to one-half of total U.S. exports go to foreign affiliates of U.S. firms.

Comprising the single largest overseas market for U.S. exports, U.S. overseas subsidiaries also return vital profits to the United States.

In 1980, for example, American subsidiaries abroad remitted $37 billion in profit to their parents in the United States. Without these foreign investment earnings, the U.S. balance of payments would be in catastrophic condition. And so it is critical that the United States continue to encourage an open international economic order, for investments as well as trade.

Unfortunately, however, a number of prospective international codes concerning investment are under discussion in the United Nations and its subsidiary bodies. The U.N. discussions tend to be confrontational in nature and propose restrictive regulations that will have debilitating economic consequences for the United States as well as our major trading partners.

I hope that agreement on effective international investment rules will be reached; otherwise we face the continued escalation of such national measures as performance requirements as a condition for licensing of foreign investment by host countries.

Unless brought under some sort of control, investment decisions internationally are increasingly going to be based on governmentally mandated distortions that are essentially uneconomic in nature.

Political divisiveness will follow and we will all be the poorer.

Under the area of general trade policy issues, we also feel that the world will be poorer if countries resort to trade restrictive devices outside the framework of longstanding international trade rules.

The theory of trade cooperation has been proved sound and practical, although its application is far from perfect. The temptations are great for governments to handle a variety of domestic economic problems through unilateral restrictions on imports or through provisions of government grants and subsidies of various sorts to stimulate bilateral arrangements.

Each unilateral action taken in trade adds to the possibility of a falling out on vital issues. With so much at stake a lessening of unity is dangerous enough; a break in that unity brought about by new trade restrictions should never be allowed to happen.

Accordingly, we in ECAT welcome the recent recommendation of a group of member companies of the GATT, that a GATT meeting of ministers of foreign countries take place in 1982.

We strongly recommend to the Congress and to the U. S. Government officials that the United States look carefully at the GATT to see whether it can be fashioned to undertake responsibility as the primary international economic institution for the development and enforcement of rules that will facilitate international investment as well as trade. It is a difficult but necessary task.

Now some specific trade issues. I would like this morning to comment on several governmentally imposed impediments.

First, the Foreign Corrupt Practices Act.

American businessmen have no quarrel with the Foreign Corrupt Practices Act's basic purpose of providing penalties for illicit payments to foreign officials. Such payments are outside the boundaries of acceptable business conduct.

However, there are problems posed by the Foreign Corrupt Practices Act, and they are those addressed in Senate bill S. 708. An ECAT panel presented our views on S. 708, on May 21, 1981, at hearings on the Foreign Corrupt Practices Act of 1977.

The clarifications of S. 708 should be a particular help to firms proposing to enter overseas markets for the first time.

ECAT's witnesses at the May 21 hearings were asked if they were able to quantify business losses attributable to the Foreign Corrupt Practice Act.

Following our ECAT appearance, on May 21, we informally surveyed our members asking if they could estimate both compliance costs and sales losses resulting from refusal to seek business because of uncertainty as to whether the Foreign Corrupt Practice Act would be violated, uncertainty that S. 708 would correct.

Many respondents simply stated that estimates were not possible. Another group responded that compliance costs had either not been increased enough to measure or had not been raised at all.

Still another group of respondents noted that their corporate standards of conduct had predated the Foreign Corrupt Practices Act, and that therefore, there could be no sales losses attributable to the Foreign Corrupt Practices Act.

But a rather large group of respondents indicated that accounting and legal compliance costs had been increased significantly, in many cases, by many millions of dollars.

A large group of companies responded that because they were uncertain whether certain business practices were prohibited by the FCPA, they refused to seek business contracts.

The uncertainties are those that S. 708 would clarify.

Admittedly, only in few cases could it be demonstrated that the Foreign Corrupt Practices Act ambiguities were the sole cause for loss of business. However, a number of companies did estimate that the ambiguities of the act were a substantial factor in losses of business which totaled over $2 billion.

Another area of concern to ECAT members is present legislation regarding export trading companies. Among measures we strongly support is legislation authorizing establishment of export trading companies.

ECAT members have also been disturbed by the U.S. Government's approach to export controls. ECAT recognizes and supports the need for export controls to protect U.S. national security. In recent years, however, we have publicly questioned the use and effectiveness of export restraints as a means of advancing the desired political changes in the internal policies of other nations.

We therefore welcome the 1979 amendments to the Export Administration Act, largely fashioned in the Senate Banking Committee, calling on the President to consider the adverse domestic economic consequences that would flow from export restraints imposed for public policy purposes.

We strongly support the requirements of the 1979 act concerning foreign availability determinations as a part of the export control process.

ECAT has also been involved in the current debate over adequate funding for Eximbank. We are hopeful that President Reagan's economic recovery program will improve the economy sufficiently so that adequate funding might be authorized for the Export Import Bank in future years.

Eximbank's current budget restraints will inhibit its ability to match foreign concessional export financing. This undoubtedly will result in a lot of lost export business with consequent losses of jobs, profits and Government tax revenues.

In light of this, we particularly commend Senator Heinz for having introduced S. 868, the Competitive Export Financing Act, which demonstrates U.S. resolve in this matter.

The U.S. objective must be to discourage the use of concessionary export financing. It is clear that official U.S. export credit assistance is needed as are improved international export credit rules if the United States is to remain competitive in the world export markets.

There is every indication that international competition will grow. We cannot afford to lose out.

Let me now turn to a most critical area on trade and investment policy; namely, taxation. An issue of considerable concern to ECAT members, as to all American businessmen with U.S. citizens working abroad is the negative impact on U.S. exports of the current U.S. tax treatment of income earned overseas by American citizens.

Most U.S. companies compensate their employees for the additional taxes involved while working abroad. These, together with other costs such as those for housing and education, make it awfully expensive for U.S. firms to keep Americans overseas.

While we have not surveyed our membership, discussions with a number of them indicate that their average base salary for U.S. overseas employees is about $50,000, and yet, it costs over $150,000 to maintain the average American abroad.

While we welcome the recent Finance Committee's approval of up to a $75,000 annual exclusion of gross income from U.S. taxation, together with a housing allowance, it is a limit that will not provide nearly enough relief for many companies to continue employing U.S. nationals abroad.

H.R. 4016, which was recently introduced by Congressmen Gibbons and Frenzel, would provide a $75,000 exclusion and a housing allowance that would go up to a $95,000 exclusion in 1985 for Americans working abroad for 11 out of 12 months.

In the case of Americans working abroad for 17 out of 18 months there would be a total exclusion of earned income from U.S. taxation. We clearly believe this is the preferable approach.

Another tax issue of concern to ECAT members is section 861 of the Internal Revenue Code. Section 861 requires the apportionment abroad to affiliates of U.S. firms of a portion of expenses incurred in the United States.

The problem for U.S. companies operating abroad arises when they file tax returns with the host country and claim a cost-of-business deduction for their share of the U.S.-incurred R. & D. expenditure, and where the foreign government disallows the expense since the R. & D. activity took place in the United States.

The result is an increase in tax costs to the U.S. corporation because of the diminution of the foreign tax credit.

Continuation of this policy discourages R. & D. investment in the United States and encourages companies to move a portion of their R. & D. to other countries.

No other countries follow this practice. In fact, many offer tax and other incentives for R. & D.

S. 1410, introduced by Senator Wallop, would provide relief by eliminating the requirement that R. & D. expenses be apportioned overseas. ECAT endorses the bill and hopes it can be adopted.

We in ECAT are also concerned with developments concerning the DISC. The legal status of of the DISC under the GATT rules is an active subject of international discussion. The DISC has been a vital export incentive. We hope that the administration, in cooperation with Congress, will insure that, if the DISC is modified, appropriate export incentives will replace it.

There are a number of other tax problems that we think require correction. For example, we believe that Congress should change foreign investment "loss recapture" rules that go beyond their intended purpose; remove tax penalties for participation in foreign boycotts that were rendered unnecessary by subsequent legislation dealing directly with the foreign boycott problem; and simplify rules fragmenting and complicating the foreign tax credit.

Again, thank you for providing me the opportunity of presenting our views on some of the current trade issues.

Senator HEINZ. Mr. Pratt, thank you very much. You have a very different view of investment abroad than Mr. Kirkland. He is very critical of investment abroad. He feels it diverts capital from this country to other countries, starves us here.

How would you reconcile your view with his?

Mr. PRATT. Well, I have always felt that labor really doesn't understand the results of investment abroad. Every study I think suggests they should support it as we do. Every study we have made suggests, as I pointed out in the paper, that a large percentage of our exports go to our organizations abroad that were created by foreign investment.

So, one of the big plusses immediately for American labor is the creation of a sizable, customer abroad for U.S.-made products, and therefore, increased jobs at home.

In addition, I should point out that the reason U.S. companies have gone abroad in the first place is because we found this to be the best, and in many cases the only, way to build sizable market positions in those countries. We are beginning to see that happen in this direction as well.

As a result of such international investments, the larger size of the company and the return profit flow increases the basic economic strength of the company and, indeed, its capital available in the United States so that they are stronger companies, better able to support work forces here.

The studies done also show that the companies that invested abroad actually grew faster in employment here in the United States than companies that did not invest abroad.

Senator HEINZ. Now, you have expressed some concern about a number of items. Creeping bilateralism. The lack of reciprocity, certainly you and Mr. Kirkland do agree on that. The need for some kind of better international understanding as to services, a services code, if you will.

You suggested that there ought to be some attempt to sit down together. You mention as a possibility the 1982 ministerial meeting of the GATT.

But, the problems we have with some of our very substantial and near trading partners in Canada and Mexico are here and now. Should we do nothing about these problems until there is a meeting of the Ministers at the GATT a year or two from now?

Mr. PRATT. No, I certainly don't think that, Senator. I believe that the administration should aggressively pursue administration of the rules and regulations that do exist now. Many of the abuses we face are covered within those rules.

I do agree with the concept of reciprocity that we should negotiate aggressively and strongly to maintain our relative position in the trade and investment world.

Senator HEINZ. Now, the administration has said they're against anything except free trade. They want lower barriers between this country and other countries.

What should the administration use to negotiate with? What are their cards they have to play? Do they have any chips to negotiate with?

Mr. PRATT. I think we have the strongest chips of all in the long run. This market is the largest and most desirable market in the world. That starts you off with a very strong chip to negotiate with.

In addition, the——

Senator HEINZ. How do we ever play that card? What do we do? Use section 301?

Mr. PRATT. Well, there are a number of ways. I am not an expert on the technicalities of various trade negotiation and trade acts. But, within the general framework of U.S. trade law as well as the recently completed MTN Agreements, I do believe we have the right to deny equivalent treatment of market access, if we are not receiving it abroad.

Yes, I think the current laws do give us authority to do that. I might ask Bob McNeill here if he has anything he wants to add on that point.

Mr. MCNEILL. No, Senator; I don't. I think that is a correct answer.

Senator HEINZ. Well, let's be a little more specific. The Japanese won't let us compete in their markets with their infant industries, computers, semiconductors, microprocessors which they are working on until they're developed. I mean, what would you do about that?

Mr. **Pratt**. Well, I think the automobile case was an example. I would agree that over the years the United States has tended to be, in my judgment, less aggressive in this kind of negotiation than our trading partners.

We could afford it, I suppose, over the last 25 or 30 years. I have always imagined that that was one of the reasons we were that way.

It was still possible, even in spite of that U.S. position, for many U.S. companies to do well in investment and in trade with Japan and other countries abroad.

As I recall the data, even after all the difficulties, our trade balance, exclusive of petroleum, is roughly in balance or even at a surplus for manufacturing and agricultural goods over most of the recent years.

So, our record in total hasn't really been all that bad. It has been a sizable part of our strength and the growing strength of the world.

But there have been cases where we have not negotiated as aggressively as some other countries. I think the time has come where we have to get more firm, and I believe the administration's plans are to do that.

I think the negotiations with regard to the automobile situation are an example of that.

Senator **Heinz**. Well, as I understand what you just said, you believe it is time to get tough in negotiation, whether it means cracking down on those people who were entering into bilaterals, or cracking down on those people who are simply erecting protectionist barriers without regard to the escape clause section of the GATT.

That is very different than what the administration says they were for last week. Now I note you are Chairman of the Advisory Committee on Trade Negotiations. You are going to have some very interesting advice to give. I hope it is heard.

Mr. **Pratt**. I am not sure there is a difference there. Obviously, there are many other national matters that impinge on trade negotiations.

I think ECAT, and I personally, believe, as does the statement of the administration, basically in free trade; free trade and investment—as free as it can be.

I am not in a position to speak for the administration. But I don't believe that anyone I have heard is suggesting that we should not firmly administer the existing rules that have been negotiated to make that free trade fair trade.

Senator **Heinz**. Mr. Pratt, before I turn you over to Senator Danforth, let me thank you for three things in your statement that you mentioned that were very helpful.

First, in another hearing in this room, back in May, I asked Mr. McNeill for more information on the amount of business lost due to the Foreign Corrupt Practices Act.

You and he have together, gone back and surveyed your membership and have come up with a $2 billion figure for lost business.

I thank you. We will make sure that is a part of the record of the FCPA hearings as well.

Second, I appreciate the support of ECAT that you have expressed for Senator Danforth's, Senator Bentsen's and my export trading companies bill. We seem to have no problems over here in the Senate. It only passed by a vote of 93 to nothing. But we can't seem to get it as yet to the floor of the House for a vote.

We hope it is a case of success having many fathers over there, but we are not sure what kind of fathers those are.

Third, you have voiced support for the so-called war chest bill that I and others have proposed as a means of showing we are serious in the export credit subsidies negotiations. I thank you for that.

If there is time, I hope you can address another issue. It is something that I think that Senator Dole and Senator Danforth are extremely interested in as well; namely, what alternatives do we have to the DISC as it is now constituted. Maybe they will ask you about that.

Senator Danforth.

Senator **Danforth**. No questions.

Senator **Heinz**. Senator Dole.

Senator **Dole**. Well, I am a late arrival. We had a hearing downstairs on another matter. But I appreciate the questions raised by Senator Heinz. I would just suggest that it is a little early for this administration to have a clearly outlined trade policy.

Many of us I think on both sides, particularly the Republican side, are going to make certain it is a more aggressive policy and be as certain as we can. That would be one area in which I think we could find broad support, because we have had sort of a pussycat trade policy over the years.

We find it in agriculture and certainly in other areas that Senator Heinz referred to and that you referred to.

With reference to some of the tax matters you mentioned, we have addressed a number of those. We are not quite as generous as you have indicated we should be, but it seems like we go to a certain point and everybody says, "You ought to do more."

I doubt we can do much more at this point. There will be in the Senate, at least, another tax bill considered hopefully this year or early next year to further address section 911 and some of the areas you expressed concern about.

The important thing now is to get the bill passed in its present form. We will start on Wednesday in the Senate. It is my hope by August 1 it will be on the President's desk.

But we have an interest in certain trade policy and part of that is tax policy and we will be addressing some of your specific concerns later this year.

Mr. **Pratt**. Thank you, Senator Dole.

Senator **Heinz**. Senator Dole, thank you.

Mr. Pratt, thank you very much. We appreciate your being here.

Mr. **Pratt**. Thank you.

[Statement of Edmund T. Pratt, Jr., follows:]

STATEMENT OF EDMUND T. PRATT, JR.
CHAIRMAN
EMERGENCY COMMITTEE FOR AMERICAN TRADE
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE
COMMITTEE ON FINANCE
AND THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
OF THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OVERSIGHT HEARING ON U.S. TRADE POLICY
Monday, July 13, 1981

STATEMENT OF EDMUND T. PRATT, JR., CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE, BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE COMMITTEE ON FINANCE AND THE SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY OF THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS OVERSIGHT HEARING ON U.S. TRADE POLICY

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Gentlemen, thank you for having me here to express some thoughts about United States trade policy on behalf of the Emergency Committee for American Trade (ECAT). I am Chairman of ECAT which is an organization of 63 business leaders whose firms have extensive overseas business interests. In 1980, ECAT member companies had worldwide sales of nearly $600 billion and employed over five million people. I am also Chairman of Pfizer Inc., and just last week was elected Chairman of the President's Advisory Committee on Trade Negotiations.

United States foreign economic policies are of vital interest to ECAT members. They profoundly affect our ability to function both abroad and at home. Along with the nation as a whole, ECAT companies have generally prospered under the United States historic commitment to and search for a worldwide economic order as free as possible from impediments to the international flow of goods and capital. We ardently hope that the United States will continue its advocacy of expansionary trade policies which have served us all so well.

FOREIGN INVESTMENT

As advocates of an open international economic order, we are greatly concerned with a number of developments at home and abroad. Paramount among them are actual and proposed unilateral or bilateral measures intended as solutions to problems that have international consequences. I have in mind such measures as narrow trade restrictions as well as measures increasingly being utilized by governments that affect investment. Indeed, I would think it sound to wager that this decade will see investment issues replacing traditional trade issues as the dominant international economic ones. What troubles me is that I am not sure just how they can or will be handled. Such existing international institutions as the GATT have had little experience in dealing with investment issues. While treaties of Friendship, Commerce and Navigation provide some protection, and while prospective bilateral investment treaties provide hope, I believe that an international agreement is called for that will establish guidelines and rules for the furtherance and protection of international investment between and among both developed and developing countries.

The importance of international investment to the U.S. economy is often overlooked. Official studies and private estimates show that from one-third to one-half of total U.S. exports go to foreign affiliates of U.S. firms. That would mean that between $74 billion and $110 billion of U.S. 1980 exports of $221 billion went to those overseas affiliates. Assuming that there are about 50,000 domestic jobs associated with each $1 billion of U.S. exports, then simple arithmetic shows that between 3.7 million to 5.5 million workers produced the U.S. exports that were shipped to the foreign affiliates of American companies. That's a lot of jobs.

Foreign direct investment also produces other economic benefits for the U.S. economy. Comprising the single largest overseas market for U.S. exports, U.S. overseas subsidiaries also return vital profits to the United States. In 1980, for example, American subsidiaries abroad remitted $37 billion in profits to their parents in the United States. Taking in account direct investment outflows from the United States by American companies and profits remitted to home countries by U.S. subsidiaries of foreign firms together totaling $8.9 billion, the United States balance of payments benefited in 1980 from U.S. foreign direct investment by a net of $28.2 billion. Without these foreign investment earnings, the United States balance of payments would be in catastrophic condition.

A number of prospective international codes concerning investment are under discussion in the United Nations and its subsidiary bodies. A code of conduct for foreign investment has been developed in the Organization for Economic Cooperation and Development -- the OECD. While the OECD voluntary code provides generally acceptable guidelines for investment activity among the advanced countries, it is not officially recognized by the developing countries where many of the investment problems are to be found.

The investment codes being considered in the United Nations and its bodies do not at the moment hold great promise for establishing acceptable international rules providing reciprocal rights and obligations. The U.N. discussions tend to be confrontational in nature. They in large part are based on a desire of the economically lesser-developed member countries of the United Nations for a "New International Economic Order" in which the advanced countries would provide unrequited benefits. While the desire is understandable, so is the reluctance of the advanced countries to agree,

I hope that agreement on effective international investment rules will be reached. They certainly are necessary if we are to further international economic activity and to maintain relative harmony in our foreign economic and political relations. Otherwise, we face the continued escalation of such national measures as performance requirements as a condition for the licensing of foreign investments by host countries. One has only to look to our northern and southern borders to see the problems that investment performance requirements can cause. In Canada, for example, a certain percentage of Canadian ownership is required for certain investments. In order to manufacture automobiles in Mexico, one must agree that 70 percent of the value of the automobile will represent value-added in Mexico. Such measures are common throughout the world. What is disturbing is that their use is rapidly growing. Unless brought under some sort of control, investment decisions internationally are increasingly going to be based on governmentally mandated distortions that are essentially uneconomic in nature. Political divisiveness will follow, and we will all be the poorer.

GENERAL TRADE POLICY ISSUES

We also feel that the world will be poorer if countries resort to trade restrictive devices outside the framework of long-standing international trade rules. The theory of trade cooperation has been proved sound and practical, although its application is far from perfect.

The challenges of dealing with government subsidies to trade, the problem of unfair pricing, the search for workable mechanisms to allow countries to deal with sudden surges in imports of specific products, and the fairness and effectiveness of systems for adjusting to import competition, all are unfilled gaps in the application of the policy of trade cooperation. While many of these challenges were dealt with in the Multilateral Trade Negotiations, a good deal remains to be done. It is our contention that the "doing" has to be in a multilateral and not a bilateral or unilateral context.

The temptations are great for governments to handle a variety of domestic economic problems through unilateral restrictions on imports, or through provisions of government grants or subsidies of various sorts to stimulate exports, or through bilateral arrangements. To the extent that such actions are pursuant to internationally agreed mechanisms, then trade retaliation may be avoided. To the extent that they are not, then retaliation is likely with the consequence that the protective action to save one man's job may cost another his through loss of an export market.

I find it rather remarkable that the industrial democracies in these times of economic stress and uncertainty have adhered as well as they have to their international trade commitments. Gulfs, however, are appearing between ourselves and our trading partners in trade practices. These could grow. Conditions could worsen. Damage could extend beyond trade. Each unilateral action taken in trade adds to the possibility of a falling-out on vital issues. With so much at stake, a lessening of unity is dangerous enough; a break in that unity brought about by new trade restrictions should never be allowed to happen.

Accordingly, we in ECAT welcome the recent recommendation of a group of member countries of the GATT that a GATT meeting of ministers of member countries take place in 1982. It would provide a wonderful opportunity to take stock of where we are, to review performance under the new GATT trade codes, to evaluate the structure of the GATT itself for the purpose of determining its adequacy to deal with current and prospective problems concerning international trade in services as well as in merchandise, and to chart a cooperative course and program for the future.

We strongly recommend to the Congress and to United States government officials that the United States look carefully at the GATT to see whether it can be fashioned to undertake responsibility as the primary international economic institution for the development and enforcement of rules that will facilitate international investment. It is a difficult but a necessary task.

SOME SPECIFIC TRADE ISSUES

I am sure that you as Senators tire of hearing the constant complaint of business that many U.S. statutes and government policies cramp the ability of American firms to compete internationally. The constancy of the complaint is because it is true. I would like this morning to comment on several governmentally imposed impediments.

THE FOREIGN CORRUPT PRACTICES ACT

American businessmen have no quarrel with the FCPA's basic purpose of providing penalties for illicit payments to foreign officials. Such payments are outside the boundaries of acceptable business conduct.

The problems posed by the FCPA are basically those addressed in S.708. We commend Senator Chafee and his colleagues for their efforts to provide needed clarification of the Act's many ambiguities. An ECAT panel presented our views on S.708 on May 21, 1981, at hearings on the Foreign Corrupt Practices Act of 1977 held jointly by the International Finance and Securities Subcommittees of the Senate Committee on Banking, Housing and Urban Affairs.

In addition to identifying the problems for ECAT members arising from the FCPA, we sought in our statement to show that the key provisions of S.708 would respond appropriately to those problems by clarifying and simplifying the bill. We also attempted to demonstrate that with the proposed changes of S.708, the FCPA would continue to fulfull the policies Congress wished to carry out in 1977.

The clarifications of S.708 should be of particular help to firms proposing to enter overseas markets for the first time. I can only imagine that the ambiguities of the present FCPA statute are sufficient in themselves to discourage smaller business firms from attempting to develop overseas business.

ECAT's witnesses at the May 21 hearings were asked if they were able to quantify business losses attributable to the FCPA. One of them noted that the compliance costs associated with the accounting provisions increased the accounting costs of his company by 25 - 30 percent. He also noted that the FCPA's ambiguities were such that his company refused to seek business that would have totaled around $20 million annually.

Following our ECAT appearance on May 21, we informally surveyed our members asking if they could estimate both compliance costs and sales losses resulting from refusals to seek business because of uncertainty as to whether the FCPA would be violated -- uncertainties that S.708 would correct. In light of the sensitivity of the issue, we were surprised to receive a goodly number of responses to our two questions.

Many respondents simply stated that estimates were not possible. Another group responded that compliance costs had either not been increased enough to measure or had not been raised at all since their corporate accounting systems already were more than adequate to meet the vague accounting standards of the FCPA. A number of respondents noted that their corporate standards of conduct had pre-dated the FCPA, and that, therefore, there could be no sales losses attributable to the FCPA.

But a rather large group of respondents indicated that accounting and legal compliance costs had been increased significantly, in many cases by many millions of dollars annually.

Others noted a large start-up cost associated with complying with the FCPA's accounting requirements but also noted modest annual additional costs of administering the new controls.

A large group of companies responded that because they were uncertain whether certain business practices were prohibited by the FCPA, they refused to seek business contracts. The uncertainties are those that S.708 would clarify. While in few cases could it be demonstrated that the FCPA ambiguities were the sole cause for losses of business, a number of companies estimated that the ambiguities of the FCPA were a factor in losses of business totaling over $2 billion.

In conducting our survey, we guaranteed that responses would be treated in absolute confidence. We believe that the results clearly demonstrate the need for enactment of S.708. Hopefully, this will be shortly accomplished.

EXPORT TRADING COMPANIES

ECAT firmly believes that Congress and the Administration should take steps to enhance U.S.international competitiveness. Among measures we strongly support is legislation authorizing establishment of export trading companies. We appreciate the efforts of Senators Heinz, Danforth and others in securing Senate passage of S.734. We are making a significant effort in the House for enactment of similar legislation.

EXPORT CONTROLS

ECAT recognizes and supports the need for export controls to protect U.S. national security. American business is willing to forego market opportunities where it is determined that the sale of products or of technology would clearly be detrimental to our national security. In recent years, however, we have publicly questioned the use and effectiveness of export restraints as a means of advancing desired political changes in the internal policies of other nations.

Americans who depend on the export sector are as concerned as any of our citizens about human rights in other nations, about discrimination against other Americans, about protection of the environment, about consumer safety, about curbing terrorism and about similar worthwhile goals of American policy. The export sector of our economy, however, increasingly appears to be the chosen instrument for the pursuit of these goals.

We, therefore, welcomed the 1979 amendments to the Export Administration Act -- largely fashioned in the Senate Banking Committee -- calling on the President to consider the adverse domestic economic consequences that would flow from export restraints imposed for public policy purposes. We strongly support the requirements of the 1979 Act concerning foreign availability determinations as a part of the export control process. It makes little sense to impose export restraints on U.S. products that are readily available from other sources -- something that happens too often.

We await with great interest the results of the Administration's study of East-West trade policies. We certainly hope that the new Administration will place heavy emphasis on U.S. exports as an important element of national security in developing its East-West trade policy.

EXPORT CREDITS

We are hopeful that President Reagan's economic recovery program will improve the economy sufficiently so that adequate funding might be authorized for the Export-Import Bank in future years. No matter what is done in other fields of export activity, financing will remain a key. Nearly all of our major foreign competitors are beneficiaries of generous export financing. The French and Japanese governments, in particular, are aggressive in export financing. To illustrate part of the problem, the French government assists in financing 30 - 35 percent of total French exports, the Japanese, 35 - 40 percent, and the United States, 6 percent.

As ECAT testified earlier this year, there would be little problem if all governments either refrained from financing exports or agreed to a common set of financing rates and rules. Such is not the case. Recognizing this, the United States has long sought to negotiate international export credit rules that would subject exporters of all nations to harmonized credit practices. As is well known, this U.S. objective has been only partly realized. While we believe it essential that the negotiations be continued, the prospects for success appear slight at the moment. Eximbank's current budget restraints will inhibit its ability to match foreign concessional export financing. This undoubtedly will result in a lot of lost export business with consequent losses of jobs, profits, and government tax revenues.

In light of this, we particularly commend Senator Heinz for having introduced S.868, the Competitive Export Financing Act, which demonstrates U.S. resolve in this matter. The bill would establish a special fund to match concessionary export credit practices of our trading partners and, thereby, help ensure that our exporters do not suffer competitive inequalities in the market place. ECAT certainly believes that need for such a fund will become a necessity if some of our trading partners persist in what amounts to an export credit war. We cannot afford to do less domestically and expect our industries to continue to be strong contenders in the world markets. The U.S. objective must be to discourage the use of concessionary export financing.

It is clear that official U.S. export credit assistance is needed as are improved international export credit rules if the United States is to remain competitive in world export markets. Every indication is that international competition will grow. We cannot afford to lose out.

TAXATION

An issue of considerable concern to ECAT members as to all American businessmen with U.S. citizens working abroad is the negative impact on U.S. exports of the current U.S. tax treatment of income earned overseas by American citizens. The high costs of sending U.S. employees abroad is very considerably exacerbated by tax costs. These high costs lead to contract losses since they can make U.S. bids uncompetitive. U.S. exports further lose when Americans are replaced abroad by foreign nationals who are likely to order products from their own countries rather than from U.S. sources.

Just the other day, I heard from one of our members that foreign equipment was ordered by a foreign national who had just replaced an American employee.

Most U.S. companies compensate their employees for the additional taxes involved while working abroad. These tax "make whole" payments are a significant cost. For one of our ECAT members, for example, tax protection in 1971 cost an average of 15 percent of base salary for their average foreign service employee. By 1979, tax protection costs had risen to 80 percent of basic salary. These, together with other costs such as those for housing and education, make it awfully expensive for U.S. firms to keep Americans overseas. For many of our member companies, it costs approximately three times the base salary to employ an American abroad.

While we have not surveyed our membership, discussions with a number of them indicate that their average base salary for overseas U.S. employees is about $50,000 and that it costs about $150,000 to maintain the average employee abroad. With these costs rapidly escalating, immediate relief from current U.S.taxation of expatriate overseas income is needed. While we welcome the recent Finance Committee's approval of up to a $75,000 annual exclusion of gross income from U.S. taxation together with a housing allowance, it is a limit that will provide some relief but not nearly enough for many companies to continue employing U.S. nationals abroad. H.R.4016, which was recently introduced by Congressmen Gibbons and Frenzel, would provide a $75,000 exclusion, and a housing allowance, that would go up to a $95,000 exclusion in 1985 for Americans working abroad for 11 out of 12 months. For Americans working abroad for 17 out of 18 months, there would be a total exclusion of earned income from U.S. taxation. We clearly believe this a preferable approach.

Another tax issue of concern to ECAT members is Section 861 of the Internal Revenue Code. Section 861 requires the apportionment abroad to affiliates of U.S. firms of a portion of expenses incurred in the United States. A particularly troublesome aspect of this section deals with the allocation of research and development expenditures. If, for example, the sales of foreign affiliates consistute 50 percent of the combined sales of a U.S. company and its foreign manufacturing subsidiaries, then the U.S. company generally must apportion 50 percent of its domestic R & D expenditures to income received from its overseas subsidiaries. The problem arises when in filing its tax return with the host country and claiming a cost-of-business deduction for its share of the U.S.-incurred R & D expenditure, the foreign government disallows the expense since the R & D activity took place in the United States. The result is an increase in tax costs to the U.S. corporation because of the diminution of the foreign tax credit. Continuation of this policy discourages R & D investment in the United States and encourages companies to move a portion of their R & D to other countries. No other countries follow this practice. In fact, many offer tax and other incentives for R & D.

The current Senate Finance Committee tax bill recognizes the need to stimulate R & D in this country by allowing a 25 percent tax credit for incremental increases in R & D. I applaud this provision. But I suggest that it is inconsistent policy to seek to stimulate investment in high technology industries, while allowing a disincentive, such as the current Section 861 regulations dealing with R & D, to exist. S.1410, introduced by Senator Wallop, would provide relief by eliminating the requirement that R & D expenses be apportioned overseas. ECAT endorses the bill, and hopes it can be adopted.

We in ECAT are also concerned with developments concerning the DISC. Our understanding was that in the subsidies code negotiated in the Multilateral Trade Negotiations it was agreed that the DISC would, in effect, be exempted from the code's provisions. We now find that this apparently was not so and that the legal status of the DISC under the GATT rules is an active subject of international discussion.

For a number of companies, and particularly for medium and smaller-size companies, the DISC is a vital export incentive. Its loss could be damaging to U.S. exports. We hope that the Administration in cooperation with the Congress will ensure that if the DISC is to be modified, an appropriate export incentive will replace it. On our part, we have constituted a group of tax experts from ECAT member companies to examine the issue and to see whether we can suggest alternative incentives to either modify or replace the DISC should such drastic action be required.

There are a number of other tax problems that we think require correction. For example, we believe that Congress should change foreign investment "loss recapture" rules that go beyond their intended purpose; remove tax penalties for participation in foreign boycotts that were rendered unnecessary by subsequent legislation dealing directly with the foreign boycott problem; and simplify rules fragmenting and complicating the foreign tax credit.

Again, thank you for providing me the opportunity of presenting our views on some of the current trade issues.

Senator HEINZ. Our next witness is Mr. Richard Simmons, the president and C.E.O. of Allegheny Ludlum Steel Corp

STATEMENT OF RICHARD SIMMONS, PRESIDENT, ALLEGHENY LUDLUM STEEL CORP.

Mr. SIMMONS. My name is Richard Simmons. I am president and chief executive officer of Allegheny Ludlum Steel Corp.

With me is Skip Hartquist, counsel for Collier, Shannon, Rill & Scott.

You have my statement and I won't read it. There are some key points, however, that I would like to stress in that statement.

First, as president of Allegheny Ludlum Steel Corp. since 1972, and as chairman of the Industry Committee, for a 5-year period from 1975 to 1980, periods during which our industry fought and won two antidumping cases and obtained no relief, a period during which we fought and won the first 201 case and won far less relief than was recommended to the President, by the ITC, the period during which our industry filed and lost a 301 case and a 337 case.

I believe that I am in a somewhat unique position to assess U.S. trade policy over the past 10 years.

That perspective would indicate to me that the United States has not had a comprehensive trade policy to our economic detriment.

It has not effectively enforced the U.S. trade laws which have been on the books for so long.

Second, that the United States desperately needs an effective trade policy, a comprehensive trade policy if it is to achieve the economic goals set by President Reagan.

Failure to develop and implement an effective trade policy, in my opinion, will doom us to economic stagnation.

Let me stress that I am not here today to speak in defense of the inefficient or the technologically obsolescent.

Nor am I here to speak in opposition to all imports. I am here to make a case for the efficient, for the technologically advanced, for the productive, whose existence is threatened by less efficient, less productive companies throughout the world only because their losses are financed by their Government.

I think it is particularly timely that during your hearings British Steel Corp. announced its annual losses and if I may read from the public statement, "The net losses of state-held British Steel Corp. increased to more than $1.3 billion," that is with a "B," and "for the first full year of Mr. McGregor's chairmanship."

Senator HEINZ. Pounds or dollars?

Mr. SIMMONS. Dollars.

Meanwhile, British Steel Corp. has given the go-ahead to the first major new steelmaking venture under its new chairman.

The new plant will make use of the latest available technology and will have a capacity of about $500,000 metric tons of steel per year.

How does a company, an industry or a Nation calculate the injury caused by such distortions carried out over long periods of time.

British Steel has lost over $6 billion in the last 5 years.

I should point out that there are economists who believe that such subsidization that permits dumping in our markets are good for the American economy.

Our trade policy until now, if it can be called a policy, has been negative and reactive, responding to immediate crises, either economic or politically caused or both.

It has been characterized by a lack of vigorous enforcement of existing trade laws, by less than sympathetic support from which ever political party was in control of the Executive Branch, by a devotion to doctrinaire free trade even when our laws were being violated, by failure to recognize that many of our free friends have increasingly turned to Government ownership and subsidization of key industries. Clear distortions of comparative advantage.

This posture, a matter of U.S. policy over many years has resulted in immense damage to specific U.S. industries and to the U.S. economy as a whole.

Increasingly international trade is characterized by endemic dumping as the world is increasingly faced with economic stress, particularly caused by the inflation in energy prices.

In my judgment, a key question for these hearings is whether any U.S. company, no matter how efficient, competitive or productive, can compete or can be expected to compete against foreign companies who do not have to meet our disciplines of profit and capital formation.

The example of British Steel Corp. is repeated throughout the world in the specialty steel industry.

Second, what can and should be, should our Government do to insure that the truly vital and truly competitive industries of the U.S. survive. The answer is: Develop a comprehensive trade policy and implement it.

The trade policy statement of the administration delivered before this hearing last week, by Ambassador Brock, is promising. Particularly so in its commitment to the recognition of the importance of trade to our economy.

The five policy components outlined by Ambassador Brock, if pursued, could provide the first effective, comprehensive trade policy in history.

We are particularly pleased that the administration has taken note of increased foreign intervention in their own economies as well as a commitment to enforce our trade laws.

But for those of us who have heard many such statements in the past, only our Government's action can give credibility to the statement.

Yet, I am encouraged by the administration's statement. But there are specific changes to our trade law and particularly to the escape clause provisions which the Congress should consider.

In addition, Allegheny Ludlum Steel Corp. is vitally interested, not just in fair trade in our home markets, but in fair trade and equal access to foreign markets.

Mr. Chairman, we are being effectively excluded on an increasing basis from foreign markets. Thus, our market to grow is becoming smaller, while our home markets are becoming more competitive.

Reciprocity and equity in this area will require firm action by the administration in its dealing with foreign nations who practice a "beggar thy neighbor" trade policy.

In closing let me repeat the closing paragraph of my statement. All imports are not bad, nor are they all good as some would say. Nor is protectionism all bad when used to protect efficient, competitive U.S. industries who have no effective defense against foreign-owned and subsidized industries abroad.

Thank you.

Senator HEINZ. Mr. Simmons, thank you very much.

You have really indicted the past enforcement of our countervailing duty and antidumping laws. You indicated that dumping is endemic world-wide. You cite the case of British Steel, which, under the auspices of the conservative Thatcher Government will be experiencing a $1.3 billion loss, that loss being made up directly out of the British Treasury. It is a good case in point, because I agree with you that at every turn of the road, more and more countries are subsidizing their industries. They are going in for both domestic and export subsidies.

The problem of subsidized export credit competition is another case in point.

In your view, since the Trade Act Agreements of 1979 became law, has there been any improvement in the enforcement of our unfair trade laws, countervailing duty, dumping, 201?

Mr. SIMMONS. No, sir.

Senator HEINZ. The Trade Act of 1979 provides for very little in the way of administrative flexibility compared to the previous laws, the countervailing duty and antidumping statutes. Where is the law falling down? Where is the enforcement falling down?

Mr. SIMMONS. In my opinion, Senator Heinz, the experience of 10 years has told me that no matter what the intent of Congress might have been when it passed the Trade Law, the lack of a vigorous commitment carrying out the will of Congress by over four administrations that I have been a witness to, is the reason why there has been little effective enforcement.

While I would choose not to use the word indictment, I would certainly lay the blame at whatever executive branch party was in control at that point in time.

We have had, in my opinion, an image of the world from the standpoint of economics that was based upon the reciprocal trade policies developed after the Second World War.

We have failed as a Nation to recognize that that period of time is passed and that the United States no longer has a superior, greatly superior position in the world.

Unfortunately, however, there is a large body of free trade economists. I call them "doctrinaire economists." They are purists. These people who have great influence in our Government, and they believe that the kind of dumping which British Steel can do in the United States is in the best interests of the United States.

While I believe in free trade, I don't believe that Adam Smith ever dealt with comparative advantage in which the Nation who claimed to have it, had it only because of Government subsidization.

So the criticism is leveled at a body of wisdom which has been translated into great influence over a long period of time, at the highest levels of Government.

I believe that the Milton Friedman School of Economics, as characterized by Mr. Wiedenbaum, would be characterized as in support of British Steel dumping in the United States.

Senator HEINZ. Does the trigger pricing mechanism permit British Steel to dump legally in the United States?

Mr. SIMMONS. Yes, it does. Legally, if one adheres or attempts to adhere to the antidumping laws or to the counterveiling duty law, as you know, Senator Heinz, the trigger price mechanism in effect makes it legal for all higher cost producing companies throughout the world to ship to the United States without fear of being accused of either dumping or counterveiling duty cases.

Senator HEINZ. Why do not other steel companies file antidumping complaints, if that is the case?

Mr. SIMMONS. Well, I think that you would have to ask the carbon steel companies involved. As you may know, we are a specialty steel producer. We are not covered by trigger prices.

But, if one goes back to the original memorandum that was sent to President Carter, prepared by Anthony Solomon, the most interesting paragraph in that entire memorandum concerning the proposed trigger price mechanism, was the fact that Mr. Solomon stated, and I think I am quoting almost verbatim:

> That if the antidumping cases currently under consideration were pursued to their logical conclusion, it would effectively exclude European steel from the United States' market.

The obvious conclusion is that politically that could not be permitted to occur.

The industry, as I understand it, was willing to accept the trigger price system, based on the advise and suggestion that this would accomplish what the industry was seeking to achieve.

Senator HEINZ. Thank you. My time has expired.

Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman.

Mr. Simmons, I think your testimony has been very interesting and very helpful.

We have had thus far, two basic trade positions which have been presented to the committee. One is the administration's position. It was characterized in the press as being one of "survival of the fittest."

The administration witnesses said that they didn't particularly like that term, but it was a strong statement of support for the concept of free trade. It was a reluctance to use a targeted economic policy to either save or encourage the growth of specific industries.

It was a reluctance to use safeguards. It was basically a statement of the position: Let's let market forces work. We believe in the market system.

While the administration stated that it believed in enforcing the trade laws, and it believed in reciprocity, the tone, in my opinion, was that the United States is going to pursue a doctrine of free trade and then try to push the rest of the world in our direction. Maybe this is an unfair characterization, but I don't think so.

But we are certainly not going to wait. We are going to adopt the policy which we think is best, try to bring the rest of the world along, but adopt our program regardless of the rest.

By contrast, today, Mr. Kirkland presented a statement which was very protective. While he said also that he favored reciprocity, at least the way I heard it, it appeared as though he was saying this deck is so stacked against us, that while we in theory support reciprocity, reciprocity is not really possible.

It appeared to me to be a statement of, "Well, let's give up on international competition. We have had it. Others don't practice it. Let's throw in the towel."

It seems to me that you maybe stating a position that is somewhere in the middle of these two positions. But I am not sure as to exactly how you would articulate the policy that you are advocating.

I wonder if you could take another crack at it.

Mr. SIMMONS. I feel more comfortable with the concept of "survival of the fittest" except that I view the administration's statement as being an abstract commitment to free trade, while I would characterize my own commitment as being a more pragmatic recognition of the real world.

I may just give you one or two very simple examples that would illustrate why I am a cynic with regard to statements by any administration, since this administration's current trade policy is really no different than those I have heard in the past.

We presently export a significant portion of our specialty steel to many countries throughout the world. We no longer can export to Brazil because they have now built a specialty steel company and our products are excluded.

We can no longer export to Mexico for the same reason.

We cannot export certain products to France, because those products are purchased by the Government-owned power company in France and they only buy from French companies.

We have great difficulty in exporting to Canada because they put a tariff on our products of 18 percent, while the same product that they may export to the United States comes in at a tariff of 6 percent.

The ability of the Canadian Government to erect an 18 percent barrier, when one keeps in mind that there is also a significant currency disadvantage going from the United States to Canada, it creates great envy in our eyes. They are able to do it without great difficulty and almost immediately.

What I am really saying to you, Senator Danforth, is that I believe in survival of the fittest if it is based on true competitive advantage, true technological advantage, and true productive advantage.

But I don't think that protecting your home industries from competition and then using the economies of scale of our market in some of the examples that I have just given you, or substantial expansion of critical industries such as specialty steel, far beyond domestic requirements and using the surplus to export to the United States, is really free trade nor fair trade.

So, hopefully, I have tried to establish a position that is not protectionist, except under the terms that I have tried to define.

Senator **Danforth**. Of course, the world is never going to be that fair. There is never going to be that ideal of absolute equity in international trade.

Mr. **Simmons**. Yes, I agree with that.

Senator **Danforth**. Which direction do we err in? If we are not going to maintain a purist position on just one extreme or another, which direction do we err in? Do we take the position we are going to be leaders in the international movement toward freer trade as the administration proposes, or do we take the position, as I gather Mr. Kirkland would take, that when the rest of the world is ready to reduce its barriers, then maybe we will talk about it.

Mr. **Simmons**. Yes; I find it very difficult to select only between the two choices that you offer me.

Senator **Danforth**. Yes; but where on the spectrum between 0 and 100, 0 being one of those positions and 100 being the other, where would you put yourself?

Mr. **Simmons**. I think it is not difficult for our country, our administration currently, to make a statement of policy in the trade area that is consistent with the policies of free trade.

But I think at the same time it can also say to our trading partners:

> Gentlemen, the two or three decades in which we have always made the first move. We have always established the policy of free trade and expected you to come along, may not be quite the same in the future, if you continue to increase your intervention in industries in which we have an interest.

I don't think there is a contradiction there for us to protect the economic self-interest of this country.

I would also say, as I said earlier, that I see no possibility for the U.S. economy to achieve the kind of growth that is being forecasted as essential without attacking this root problem.

Senator **Heinz**. Senator Dole.

Senator **Dole**. Just very briefly. As I understand, there is an import monitoring system in place for specialty steel; is that correct?

Mr. **Simmons**. Yes, sir.

Senator **Dole**. You are not suggesting we eliminate that, are you?

Mr. **Simmons**. No.

Senator **Dole**. Has it been successful?

Mr. **Simmons**. It is too early to say. It has only been in place a short period of time. The new administration has really just staffed up. So that I am in no position to be able to say that it is not working at this point in time.

One product has been identified as having exceeded the limits established by the Commerce Department. The Commerce Department is currently investigating them.

Senator **Dole**. But I think you would indicate at least there is some hope that it might stem unfair competition.

Mr. **Simmons**. Yes, and as I indicated earlier, we are quite encouraged by the statement of trade policy, as enunciated by Ambassador Brock.

I also went on to say that it is important for us to see whether or not such a policy is really implemented.

Senator Heinz. Mr. Simmons, I will just make a brief comment, maybe as a means of eliciting a little further response to the intriguing question that Senator Danforth asked.

When we asked the administration whether they intended a new get tough policy on enforcing our fair trading laws, they said they favored a get tough policy, but it wasn't new. They were going to do the same thing as previous administrations. They were going to enforce the letter and the spirit of the law with vigor and everything else.

Now you and I know that if you look at the history of the enforcement of U.S. trade laws, fair trade laws, that the last thing they have been enforced with is vigor, with the spirit, letter or intent which Congress had implied or stated.

Why wouldn't a good statement of your policy as distinct from the administration's survival of the fittest, or Fortress America as Danforth Kirkland——

Why wouldn't a good statement—the Danforth interpretation, excuse me. [Laughter.]

Senator Heinz. Why wouldn't a good statement be vigorous action unlike that previously taken in defense of our interests, while at the same time we seek through multilateral means, methods of enforcing a better discipline and order.

Why wouldn't just much stronger enforcement be what would separate you from both those alternatives?

Mr. Simmons. Well, I would totally support such a position. As you and I know, our trade laws have been—have not been enforced over time. In fact, President Carter, in 1978, when the trigger price system was put in for carbon steel, stated that the antidumping laws had not been enforced over time.

So, I don't think it is an accurate statement for anyone to say that they have been vigorously enforced in the past. The record would indicate that is not true.

I would also point out that were it not for the section 201 of the 1974 trade act, the escape clause case, a so-called fair trade provision, especially the steel industry, which had failed, even though it won two dumping cases, failed to win relief, would not be nearly as competitive and technologically advanced today as it is.

I would support your suggestion.

Senator Heinz. Now one other item. You suggested some specific changes in section 201, in the escape clause section. Are they contained in your statement?

Mr. Simmons. No, they are not. But I would be glad to outline them for you right now if you would like to hear them.

I think there are two key problems with section 201.

The first problem is the fact that the President can ignore the decision of the United States ITC and his decision can only be overruled by a majority of Congress which is very difficult to obtain on a single issue.

One of the specific changes that that would propose—that I would propose, that the President would have to accept the decision, the recommendation of the ITC unless he obtained a majority or two-thirds vote of the Congress.

I think if we put it in a positive rather than in a negative fashion that the ITC decisions which are semijudicial decision, made only after public hearings, expensive staff research, would be—would certainly strengthen the law.

I would also point out that under the present provisions of 201, the industry must prove three things. They must prove a rising trend of imports, injury and that injury was caused mostly by imports.

This means that an industry which perhaps has faced a lack of vigorous enforcement over 10 years, and which has given up 50 percent of its market, as an example, cannot prove a rising trend if imports remain at the 50-percent level.

There should be some threshold level to give recognition to the very fact that our trade laws have not been effectively enforced over two decades.

Senator HEINZ. Thank you very much.

Mr. SIMMONS. Thank you.

Senator HEINZ. It is a very helpful, comprehensive statement, I might add.

[The prepared statement of R. P. Simmons follows:]

TESTIMONY OF

MR. R. P. SIMMONS

PRESIDENT

ALLEGHENY LUDLUM STEEL CORPORATION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

SENATE COMMITTEE ON FINANCE

AND

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND

MONETARY POLICY

SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

OVERSIGHT HEARING ON U.S. TRADE POLICY

July 13, 1981

Summary of Principal Points

1. The United States has not had and does not have a comprehensive trade policy. We desperately need one if we are to achieve the revitalization of our economy.
2. Developed as well as underdeveloped nations are increasingly using the United States as an outlet for their exports even when it is not profitable to do so in order to achieve other national purposes such as maintenance of employment, social and political goals, national prestige and improved trade balances with the United States.
3. Enforcement of U.S. trade statutes is an essential part of an effective trade policy.
4. The history of enforcement indicates clearly that trade statutes have not been effectively and vigorously enforced.
5. The specialty steel industry escape clause case is reviewed as a clear case where the industry used the relief granted to improve competitiveness and modernize its facilities when prior victories and antidumping suits provided no relief. The importance of the escape clause procedure to efficient U.S. industries is stressed.
6. The intent of Congress has frequently been ignored by those charged with the administration and enforcement of U.S. trade laws.
7. Reciprocity and equity between trading countries is an essential part of any U.S. trade policy. Examples are

presented where U.S. countries are denied equal access to foreign markets.

8. The United States is at a crossroads in international trade. If we are to once again have a growing economy to provide the jobs our nation needs now, we must also have an effective trade policy to permit efficient, competitive U.S. companies to succeed or fail on their merits, not as a result of decisions made by foreign governments.

Chairman Heinz, Chairman Danforth, and Members of the Subcommittees: I appreciate the opportunity to testify before you today on a subject so important to American industry. The issues involving international trade could well be as vital to the survival of our free market system as any the United States will face in the coming decade. I believe it is particularly appropriate for your Committees to examine United States trade policy in this, the first year of a new Administration.

Let me say at the outset that I am not here in defense of inefficient or technologically obsolescent companies or industries. Nor am I here to speak in opposition to all imports. I am here to make a case for the efficient, for the productive, for the technologically advanced companies of the United States whose existence has been and is being threatened by foreign companies throughout the world, owned or subsidized by their governments.

As someone who has been a witness to the administration of United States trade policy for the past ten years, it is clear to me, at least, that the United States has not had a comprehensive trade policy. Further, I believe that we desperately need one if the United States is to meet the economic goals set by President Reagan for the coming years. Our past policies can be characterized as "reactive" and "negative" dealing with the immediate problem at hand. It is generally agreed by those who are knowledgeable in trade matters that no serious attempts have been made to develop a comprehensive policy which would encompass all aspects of the complex economic and political issues involved in international trade. The resolution of these issues would be in our nation's self-interest while at the same time maintaining the principle of "equity" with our trading partners. The key considerations include enforcement of U.S. trade laws; access to foreign markets, tax policy and capital recovery to enhance U.S. investment; export financing to match that of foreign nations; actions against nations which do not abide by international trade laws and equity toward those nations that do. In other words, to be effective, trade policy must be a coordinated effort of many departments of government over an extended period of time with a real commitment by the President that if our economy is to be strong and growing the private sector must be given a fair chance to compete throughout the world.

A major ecomomic event of recent years is the increasing tendency of many free nations of the world to politicize their economies. We have learned to recognize the role of government in the managed economies of socialist countries. We have not recognized the same government involvement, on a more gradual basis, in the supposedly free countries of the world. With increasing frequency, our free friends are using their own economies and specific strategic industries to distort the economies of free trade. Many of these nations are using the

United States market as outlets for their goods even when it is not economic or profitable to do so, in order to achieve other, broader, national purposes including maintenance of employment, social and political goals, national prestige and improved trade balances with the United States.

It is in the area of unfair import competition that I will focus most of my remaining comments.

When the records of enforcement and administration of United States trade statutes are examined, including antidumping, countervailing duty and predatory pricing statutes, it is difficult to be optimistic, regardless of the merits of the case, in bringing an action under one of these statutes. The history for the past twenty years is clear. Regardless of the Administration in power, those in the positions to pursue and enforce United States trade statutes have generally been adversarial to the U.S. company or industries bringing the action. The long history of influential "free traders" both in and outside of government coupled with the frequent sacrifice of trade interests to the greater importance of foreign policy considerations have caused immense, but difficult to measure, harm to American businesses and the American economy as well.

What is the incremental damage of lowered profits over a long period of time caused by "unfair" trade practices? Even if a U.S. company remains profitable, lowered profits reduces its ability to reinvest, to modernize and to expand. The record would indicate clearly that relief under our laws comes only when the patient is close to death and then only in small doses.

Even when victory is achieved, the relief is often so slight, the time so long to achieve it, that the victory is generally moot.

Compared to other nations' commitments to their own economic self-interest, their aggressive, positive posture to protect their own industries -- ours pales by comparsion.

No longer is it simply the smaller, weaker industries that are being injured by imports.

Today, instead, it is industries like automobiles, steel, specialty steel, electronics, office equipment, computers, machine tools, fasteners, and footwear that are in trouble. These are major industries, employing hundreds of thousands of people, industries that are fundamental to our domestic economy.

Increasingly, international trade is characterized by endemic dumping, foreign government ownership and subsidization of the means of production. As you know, dumping is essentially the selling of products in the U.S. market by a foreign producer at prices lower than those in his home market or below cost. The assumption of the law is that there are additional costs in shipping products from a foreign country to the U.S., such as transportation and customs duties. Logically, therefore, the price of the same product should be higher in the U.S. market than in the foreign market where it is produced. At the least, it should be no lower.

Sometimes dumping appears to make sense to certain foreign companies where employee layoffs are avoided at all costs for social reasons. The work force is considered to be a fixed cost, rather than a variable cost. In such a situation, it may appear logical from a business point of view to sell products abroad at a loss while selling the same product at home at a profit. Nevertheless, such business practices clearly violate U.S. and international trade laws.

Similarly, we see more and more evidence of foreign government subsidization of products sold in the American marketplace. Under the Trade Agreements Act of 1979, subsidies are defined to include export subsidies, government grants, loans, or loan guarantees, the provision of goods or services at preferential rates, and other similar benefits. The interesting thing about subsidization is that those industries chosen for subsidies by foreign governments are not necessarily targeted for economic reasons, but frequently to attain political or strategic goals. Specialty steel is a good example. Many specialty steel mills built or planned around the world with government funds cannot meet the economic test of anticipated profitability. Yet, these mills are built, adding unnecessarily to world capacity, and adding to the difficulties profit-oriented industries like ours have in meeting subsidized price competition. Ironically, some of those mills use Eximbank financing at interest rates less than half our borrowing rate of interest.

In my judgment, key questions for this hearing are these: How can an efficient, modern United States industry compete against foreign producers who are not subject to the disciplines of profit and capital formation which are fundamental to the free enterprise system? Secondly, what can and should our government do to insure that our truly competitive industries survive?

A Case in Point - Specialty Steel

My own industry, specialty steel, is an excellent case in point. Prior to 1960, imports of specialty steel were not a significant problem. Beginning in the 1960's and accelerating into the early 1970's, import penetration increased substantially. In 1973 the domestic industry brought and won two antidumping cases, one against Swedish plate producers of stainless steel and the other against French producers of stainless steel wire rod. Even though we were successful, however, the Treasury Department, which had jurisdiction over antidumping cases at that time, did little to enforce the law. In fact, under the Freedom of Information Act, we learned recently that no record exists of any duties levied or collected. The point is, we used the law, and the law did not work.

In 1975, the domestic specialty steel industry filed an escape clause case with the International Trade Commission. That case led to a strong finding of injury by the ITC, and in 1976 a decision by President Ford imposed the toughest form of import relief possible -- import quotas. Japan agreed to an orderly marketing agreement. The European Community did not, so import quotas were imposed on the EC.

It is interesting to examine why the American specialty steel industry filed an escape clause petition -- a so-called "Fair Trade" statute. The answer is apparent when one looks at the facts. The industry had filed and won two antidumping cases with little or no relief.

The problem of dumping in 1975, at the bottom of the worst worldwide recession since the Depression, had become endemic. The time and resources required to document and prepare a broad series of dumping cases against many nations was beyond the ability of this rather small industry. The escape clause petition was the only viable option open to the specialty steel industry. While escape clause petitions do not normally deal with unfair trade practices, the specialty steel industry used this case to identify, nation by nation and product by product, a wide range of government subsidies, below cost sales and less than fair value sales.

It is not an overstatement to say that without the escape clause provisions of our trade laws as passed by Congress, the specialty steel industry today would not be competitive, modern and technologically advanced. We would be another industry whose survival is in doubt.

During the three and one-half years of import restraint ending in February, 1980, the specialty steel industry acted responsibly and effectively. Research and development expenditures were increased. Capital investment was increased. Furthermore, due to intense domestic competition, prices of specialty steel products were not substantially increased, as documented in two studies by the Department of Labor. The United States specialty steel industry did not take advantage of the fact that imports were restricted (but allowed to grow three percent each year).

We should remember that the U.S. specialty steel industry is and always has been a profitable, efficient industry. Nobody has ever accused us of being outdated or inefficient. To the contrary, all parties have agreed in three separate ITC hearings that the specialty steel industry of the U.S. is efficient and technologically advanced. The study of the steel industry by the Office of Technology Assessment confirmed this in its report. But, our foreign competition frequently need not meet the test of efficiency. There has been many years in which the U.S. specialty steel industry was the only one worldwide which was profitable. But, due to government subsidies or ownership, foreign producers can price their products at levels which are unprofitable and well below ours. In many cases, their prices do not even cover production costs. Yet, they are able to take market share from us.

Is this fair competition? No. Is it lawful? No. Yet there are economists who have stated that dumping or other subsidized below cost sales benefit our society. I suggest that those who make these statements do not measure the full costs to our society. More important, however, is the threat to our free market system if U.S. companies can be driven out of business or permanently damaged -- not by the more efficient, more productive or technologically advanced -- but rather by the government that provides the capital for reinvestment or the subsidy to turn a loss into a profit.

The key point is that competitive U.S. industries can compete if our trade laws are effectively enforced and strictly administered as they were in the case of specialty steel. However, the laws will be no more effective than the will and vigor or those charged with their enforcement. Regardless of the intent of Congress in writing the law, the administration of the law becomes paramount.

The Multilateral Trade Negotiations and the Trade Agreements Act of 1979

Following the MTN negotiations, Congress passed the Trade Agreements Act of 1979. The new law transferred jurisdiction over antidumping and countervailing duty cases to the Department of Commece where hopefully the law will be administered more in the economic self-interest of the U.S. The law strengthened the language of our unfair trade statutes, and defined injury more clearly. How these strengthened statutes will be administered remains to be seen.

But, it should be noted that unlike our antitrust laws, the unfair trade practice laws do not penalize the foreign producer for business misconduct. In essence, after unfair practices have been used to gain market share and injury to United States industry, we simply say "stop it." While we force the payment of additional duties in the future, designed to make up for the current discrimination being practiced, there are no treble damage provisions. There is no financial penalty paid to the U.S. victim of these practices. Isn't the result of lost jobs, closed factories, and lost profits just as criminal as a violation of our antitrust laws?

Reciprocity and Equal Market Access

The United States market is the biggest, most open, most attractive in the world. By the same token, the U.S. government is often the slowest in the world to act against unfair trade practices. A key issue in international trade for U.S. industry is not just increased penetration of our markets, but increasing our exclusion from export markets. As other nations overtly or covertly exclude U.S. producers from their home markets, our ability to invest and expand is reduced. Indeed, we frequently have the worst of all worlds. If we are to revitalize our economy and improve our ability to compete worldwide, we must have the same access to foreign markets that our competitors have here. Let me give you some examples.

1. Buy National Provisions. The MTN government procurement code called for an end to "Buy America" and

other foreign "buy national" practices. Our government has already implemented a broad waiver of existing Buy American statutes. How many foreign governments have done the same thing in any material way? How much more access have we gained to foreign government projects?

2. We cannot sell specialty steel in many countries which have recently built specialty steel plants. Where a market for our products existed in such countries as Brazil and Mexico, those markets are now closed to us if the product can be produced by home market plants.
3. Capacity, double or triple domestic needs, has been or is being installed in Finland, Taiwan, Spain, and the United Kingdom. The surplus is exported, frequently at any cost, to the detriment of American companies.
4. Specialty steel such as stainless steel cannot be sold by U.S. producers to foreign government-owned utilities. Utilities such as the electric power companies of most other nations are government owned. They purchase only from their own domestic specialty steel companies (frequently also government owned).
5. In Japan where government involvement is much more subtle, but nonetheless effective, our products cannot penetrate to any significant degree regardless of our price.

6. Even our good friends in Canada have 18 percent duties for any specialty steel products which are produced by Canadian firms. Their government moves with enviable speed to protect their strategic industries when threatened by imports. Yet the same products move to the United States with duties of only six percent and that level is in the process of being reduced as part of the last MTN agreement. Is that equity?

What Should the United States Do?

I believe that the United States is at a unique point in history. We have the opportunity as a nation to set new goals and directions which will lead to a revitalization of our economy and our nation. As part of this process, and an important part, is the need for an effective trade policy which addresses the questions that you have raised at these hearings. The time has come for an effective trade policy as an integral part of the new economic directions we are taking as a nation.

Tax reform to encourage investment will be of little incentive to companies such as mine if control of our success is primarily in the hands of a foreign government and its decisions.

As Chief Executive Officer of one of the largest specialty steel companies in the United States, let me assure you that we are willing to compete. We are eager to compete. And we are sure that we can compete -- IF -- and this is a big IF -- our foreign competitors must meet our disciplines of profit and capital formation.

A part of an effective trade policy is the clear need for vigorous enforcement of our trade laws to let U.S. companies know that they will be given a "fair" chance to succeed or fail. Let me assure you that Allegheny Ludlum and the specialty steel industry are willing to accept that challenge. Vigorous enforcement of U.S. laws will tell the rest of the world that they cannot "Begger thy Neighbor" with impunity. Reciprocity and equity in the area of trade must be essential parts of our trade policy as well.

Enforcement of our trade laws is a critical issue for my company, for the specialty steel industry and for all of American industry. I believe it is equally a critical issue for the Congress and the Administration. I can tell you that the specialty steel industry will continue to fight the battle against unfair trade with every weapon at our disposal. We intend to survive and prosper. We call upon you to help create the environment in which we can best do so.

Mr. Chairman, let me close by reaffirming that all imports are not "bad." But nor are they all "good" as some would claim. Nor is "protectionism" all bad when it is used to protect efficient and competitive American companies and American jobs from predatory practices against which we have had no effective defense and which, in many cases, may be illegal under American laws.

Thank you.

Senator **Heinz**. Our next witness is Mr. James Geier, chief executive officer, Cincinnati Milacron, Inc.

STATEMENT OF JAMES A. D. GEIER, PRESIDENT AND CHAIRMAN OF THE BOARD, CINCINNATI MILACRON, INC.

Mr. **Mills**. Mr. Chairman, if I may, I would like to present the next witness, Mr. James Geier, who is the chief executive officer of Cincinnati Milacron, Inc, in Cincinnati, Ohio. He has a very fine statement that I am sure you will receive.

I give you Mr. Geier.

Senator **Heinz**. Thank you.

Mr. Geier.

Mr. **Geier**. With me is Paul Rutherford, director of corporate taxes for Cincinnati Milacron.

We are headquartered in Cincinnati, Ohio. Cincinnati Milacron is engaged principally in the design, construction, sales, and service of production and processing equipment and supplies for manufacturing and defense industry.

We are the largest manufacturer of machine tools and the largest manufacturer of plastic machinery in the free world.

In the 1950's we pioneered the marrying of electronic technological controls for machine tools.

Today we are one of the leading producers of computer control manufacturing systems and sophisticated industrial robots.

We market our products in approximately 100 countries. In world markets we compete with manufacturers from all the industrialized countries, including Japan, Germany, France, Sweden, and Italy.

We appreciate the opportunity to appear before you to present our views on the importance of international trade to Cincinnati Milacron and to comment on certain trade barriers.

I will summarize our comments for the committee and ask that the full extent of our testimony be included in the record.

The United States no longer leads in many world markets, nor is it alone in the manufacture of major industrial equipment. Competition has become global.

U.S. companies must now compete with the best and the biggest of foreign competitors not only in the foreign markets, but also in the U.S. market.

Only those companies, U.S. or foreign, which achieve the greatest economies of scale are likely to survive in the competition for world markets.

Cincinnati Milacron began exporting in the 1890's and ever since we have sought to expand our world market.

Today we must also export to help protect our U.S. markets. If we do not compete on a global scale, eventually we will not compete in our own country.

In the machine tool industry, Japanese manufacturers and others compete directly for our U.S. markets. The Japanese also compete most effectively in Europe and other markets.

Companies that intend to compete internationally need a highly developed international presence. Even though most of our equipment is manufactured in the United States, we must also be present overseas for many reasons; to sell our products, to install and service what we sell, to keep abreast of changing markets, and to have access to foreign developing technology.

We must also be present overseas to achieve economies of scale so we remain competitive and maintain the growth necessary for the long-term survival.

Each year we ship millions of dollars of components and subassemblies to our European subsidiaries to support their operations. These exports also provide a great many U.S. jobs and help us stay competitive overseas.

There are risks when we do business in the United States, but there are many more risks in international markets such as the instability of foreign governments, foreign laws and practices, local foreign competition, fluctuating exchange rates, and foreign government subsidies to their manufacturing industries.

But even when a company recognizes these additional risks, and decides to accept the challenge of competing internationally, they must overcome yet other barriers.

Certain laws and regulations of our own Government. The Government has made it needlessly difficult for American companies to compete effectively in international markets. Acting with the best intentions, Congress will sometimes pass a law to close a tax loophole or to achieve some other purpose, but they do not realize they may be creating barriers for U.S. companies that do business in international markets.

A number of these handicaps that our American Government imposes on American companies have been touched on in these hearings.

Permit me to highlight two or three more.

I am proud to be part of an American company that has been in business since 1884. I can assure you that our history has not been one of 97 years of unqualified successes. Like any company, Cincinnati Milacron has had its ups and downs.

We are a leader in our businesses because our success has more than outweighed our failures.

If we don't succeed, we just try harder the next time. This is the way we have played the game. It is the way we would like to go on playing it, if the Congress will let us.

Let me cite an example of one thing that the Congress did that makes it hard for a company to regain its stride if it happens to stumble in one of its overseas ventures.

The Tax Reform Act of 1976 made a number of changes in the foreign tax credit provisions of the Internal Revenue Code. These are amendments—these 1976 amendments were made to close up a loophole which enabled some corporations to practice tax avoidance.

This loophole allowed companies to offset foreign start-up losses against domestic income. When the foreign venture became profitable, it could be converted into a wholly owned foreign company. The profits of the foreign company were subject to U.S. taxes only when and if it brought them back to the United States.

I am not here to defend this combination of deductions of initial losses from a foreign operation and then sheltering subsequent profits with the same operation.

I do not fault the Congress for trying to end the so-called double dipping, but I am concerned about the way Congress did it.

Congress attempted to put an end to double dipping by recapturing all foreign losses to offset any subsequent foreign income regardless of origin.

This reduced subsequent foreign tax credit available to a company. These changes in the code are applied on an overall, worldwide basis.

As a result, losses arising in the country would be recaptured against future income received from unrelated operations in the same or different country.

This substantial increase, increases the effect of tax rate on unrelated foreign earnings when they are repatriated.

Let me illustrate the consequences of this change in the tax code.

Let us assume that the competitive situation makes it clear we must have operations in Germany. The obvious business judgment would be to go to Germany. This law has made this seemingly easy business decision extremely difficult to make. Here is why.

Let's suppose that the German venture turns out to be unsuccessful and is terminated. Today the losses incurred by this termination would cause profits earned in say England, to be taxed at an unacceptably high rate because of German losses would be recaptured against the English income.

We believe that this result exceeds the original objective.

An unsuccessful foreign operation which has been terminated, cannot produce subsequent foreign income which might escape U.S. tax.

Therefore, termination losses can only be recaptured against unrelated foreign income.

In other words, there can be no double dipping once a foreign subsidiary is terminated.

The recapture of losses incurred upon termination of a foreign subsidiary, penalizes all past, unrepatriated earnings, all current foreign earnings and all future foreign earnings of current or subsequent foreign operations.

We believe the tax penalty is an imprudent international trade policy. It should be not applied to U.S. companies competing for world markets.

To put it in perspective, many other industrialized countries do not even attempt to tax income earned by their companies outside of their borders.

I see we are short on time. So, we have talked—you heard this morning about two other areas that we would like to talk about. One is the penalizing of sending Americans overseas and the other is the research and the penalty on research.

So, Mr. Chairman, perhaps with this 5-minute time limitation, we can stop at this point.

Senator HEINZ. Very well, Mr. Geier. Without objection, your entire statement will be a part of the record.

Senator Danforth.

Senator DANFORTH. No questions.

Senator HEINZ. Senator Dole.

Senator **Dole**. I have no questions except to state that we are addressing the last points in your statement, at least the one on section 911, in the Tax Code, to be taken up Wednesday.

The others, S. 1410 and I think one other you mentioned in the tax area, I assume we will be addressing later this year. I am not certain we can accommodate every request, but we are looking at areas for our second tax proposal.

As Mr. Mills knows, we are serious about it. It is not a game we are playing to keep amendments off the first bill. But we hope we will be successful in fending off amendments so the present economic package can really start to go.

We appreciate your testimony. I am not as familiar with the trade portion of it as the tax portion of it. We are going to be addressing that soon.

Mr. **Geier**. We appreciate that very much.

Mr. **Mills**. I want to thank you, Mr. Chairman, for the opportunity, too.

Thank you.

Senator **Heinz**. Mr. Mills. Mr. Geier.

Thank you very much.

[Statement of James A. D. Geier follows:]

CINCINNATI
MILACRON

ORAL STATEMENT

OF

JAMES A. D. GEIER
PRESIDENT AND CHAIRMAN OF THE BOARD
CINCINNATI MILACRON INC.

Before the

Subcommittee on International Trade of the
Senate Finance Committee

and

Subcommittee on International Finance
and Monetary Policy of the Senate
Banking, Housing, and Urban
Affairs Committee

July 13, 1981

CINCINNATI
MILACRON

STATEMENT OF JAMES A. D. GEIER
CINCINNATI MILACRON INC.
JULY 13, 1981

SUMMARY

-- The Foreign Loss Recapture rules enacted in 1976 require all foreign losses to be "recaptured" against any subsequent foreign income, thereby reducing foreign tax credits related to that income.

-- The 1976 rules were intended to eliminate "double-dipping" whereby U.S. companies might receive a tax benefit through a combination of deductions for foreign losses followed by foreign tax credits to reduce U.S. tax on subsequent earnings from the same foreign operations.

-- A terminated unsuccessful foreign subsidiary can never produce the foreign income which it was feared might escape full U.S. taxation and therefore losses from termination can only be "recaptured" against unrelated foreign income, thereby increasing the effective tax rate on that income.

-- This result exceeds the intent of the legislation and provides U.S. companies with significant disincentives to continue to compete for world markets after they have incurred any foreign termination losses.

-- If U.S. companies do not compete for world markets, they will lose economies of scale and eventually become non-competitive with a resulting loss of U.S. jobs.

-- The 1976 rules also induce U.S. companies to defer repatriation of foreign income, thereby depriving projects in the U.S. of needed capital and negatively affecting the nation's balance of payments.

-- Any law which causes U.S. companies to surrender foreign markets or defer repatriation of foreign earnings constitutes undesirable trade policy.

-- Section 904(f) of the Internal Revenue Code should be amended to delete foreign termination losses from the Foreign Loss Recapture provisions.

-- Regulations requiring allocation of U.S. research and development expense to income earned abroad raise the effective tax rate on unrelated foreign income and provide an incentive for U.S. companies to conduct research and development outside the U.S.

-- S.1410 and H.R.2473 would remove the R&D allocation requirement and the incentive to move R&D outside the U.S. and should receive favorable legislative action.

-- Taxation of U.S. citizens working and residing overseas makes them very expensive for U.S. companies to employ and puts U.S. companies at a competitive disadvantage. The Senate Finance Committee has dealt in part with this problem in its recently reported tax bill. Taxes on American citizens working and residing abroad should be substantially reduced or eliminated.

Good morning!

My name is James Geier and I am President, Chairman of the Board, and Chief Executive Officer of Cincinnati Milacron Inc. As the name suggests, we are headquartered in Cincinnati, Ohio. Cincinnati Milacron is engaged principally in the design, construction, sales and service of production and processing equipment and supplies for manufacturing and defense industries. We are the largest manufacturer of machine tools and plastics processing machinery in the free world.

In the 1950's, we pioneered in marrying electronic technology to our machine tools. Today, we have also become one of the world's leading producers of computer controlled manufacturing systems and sophisticated industrial robots. We market our products in approximately 100 countries. In world markets we compete with foreign manufacturers located in most of the industrialized countries of the world including Japan, Germany, France, Sweden, and Italy.

We appreciate the opportunity to appear before you and to present our views on the importance of international trade to Cincinnati Milacron and to comment on certain trade barriers. I will summarize our comments for the Committee and ask that the full extent of our testimony be included in the record.

The United States no longer leads in many world markets nor is it alone in the manufacture of major industrial equipment. The competition has become global. U.S. companies must now compete with the best and the biggest of foreign competitors, not only for foreign markets, but also for U.S. markets. Only those companies, U.S. or foreign, which achieve the greatest economies of scale, are likely to survive in the competition for world markets.

Cincinnati Milacron began exporting in the 1890's and ever since we have sought to expand its world markets. Today, we must also export to help protect our U.S. markets. If we do not compete on a global scale then eventually we will not be competitive in our own country. In the machine tool industry, Japanese manufacturers and others compete directly for our U.S. markets. The Japanese also compete most effectively in European and other markets.

Companies that intend to compete internationally need a highly developed international presence. Even though most of our equipment is manufactured in the United States, we must be present overseas for many reasons: to sell our products; to install and service what we sell; to keep abreast of changing markets; and to have access to foreign developing technologies.

We must be present overseas to achieve economies of scale in order to remain competitive and to maintain the growth that is necessary for our long term survival. Each year, we ship millions of dollars of components and sub-assemblies to our European subsidiaries to support their operations. These exports also provide a good many U.S. jobs and help us remain competitive overseas.

There are risks of doing business in the United States. There are many more risks in international markets, such as: the instability of foreign governments; foreign laws and practices; local foreign competition; fluctuating exchange rates; and foreign government subsidies to their local manufacturing industries. But even when a company recognizes these additional risks and decides to accept the challenge of competing internationally, it must overcome yet other barriers - certain laws and regulations of our own government.

Government has made it needlessly difficult for American companies to compete effectively in international markets. Acting with the best of intentions, Congress will sometimes pass a law to close a tax loophole, or to achieve some other purpose, without realizing that they may be creating barriers for U.S. companies that do business in international markets.

A number of these handicaps that our American government imposes on American companies have been touched on in these hearings. Permit me to highlight two or three more.

I am proud to be a part of an American company that has been in business since 1884. I can assure you that our history has not been one of 97 years of unqualified success. Like any company, Cincinnati Milacron has had its ups and downs. We are a leader in our businesses because our successes have more than outweighed our failures. If we don't succeed we just try harder the next time. This is the way we have played the game. It's the way we would like to go on playing it, if the Congress will let us.

Let me cite an example of one thing the Congress did that makes it hard for a company to regain its stride if it happens to stumble in one of its overseas ventures.

The Tax Reform Act of 1976 made a number of changes in the foreign tax credit provisions of the Internal Revenue Code. These 1976 amendments were aimed at closing a "loophole" which enabled some corporations to practice tax avoidance. This "loophole" allowed companies to offset foreign "start-up losses" against domestic income. When the foreign venture became profitable, it could be converted into a wholly-owned foreign company. The profits of the foreign company were subject to U.S. taxes only when and if brought back to the United States.

I am not here to defend this combination of deductions for initial losses of a foreign operation and the sheltering of subsequent profits from the same operation. I do not fault the Congress for trying to end this, so called, "double-dipping" but I am concerned about the way Congress did it.

Congress attempted to put an end to "double-dipping" by "recapturing" all foreign losses to offset any subsequent foreign income, regardless of origin. This reduced subsequent foreign tax credits available to a company. These changes in the Code are applied on an overall worldwide basis. As a result, losses arising in one country are "recaptured" against future income received from unrelated operations in the same or different countries. This substantially increases the effective tax rate on unrelated foreign earnings when they are repatriated.

Let me illustrate the consequences of this change in the tax code.

Let's assume the competitive situation makes it clear that we must have operations in Germany. The obvious business judgment would be to go to Germany. This law has made this seemingly easy business decision extremely difficult to make. Here's why. Let's suppose that the German venture turns out to be unsuccessful, and it is terminated. Today, losses incurred by this termination would cause profits earned in, say, England to be taxed at an unacceptably high tax rate because the German loss would be "recaptured" against the English income.

We believe that this result exceeds the original objective because an unsuccessful foreign operation which has been terminated cannot produce subsequent foreign income which might escape U.S. tax. Therefore, termination losses can only be "recaptured" against unrelated foreign income. In other words, there can be no "double-dipping" once a foreign subsidiary is terminated.

The "recapture" of losses incurred upon the termination of a foreign subsidiary penalizes: 1.) All past unrepatriated earnings; 2.) All current foreign earnings; and 3.) All future foreign earnings of current or subsequent foreign operations.

We believe that this tax penalty constitutes an imprudent international trade policy. It should not be applied to U.S. companies competing for world markets. To put this into perspective, many other industrialized countries do not even attempt to tax income earned by their companies outside their own borders.

Trade policies come in many guises. How a company is taxed will affect the policy by which it operates. If we penalize U.S. companies when foreign operations are successful, then many U.S. companies will be less willing and less able to compete for new foreign markets or even to protect their existing foreign markets. Moreover, if U.S. companies surrender these foreign markets to their competitors, they will lose economies of scale. Eventually they could become noncompetitive. This would jeopardize their domestic markets and the jobs of their U.S. workers. Laws should not cause U.S. companies to consider surrendering foreign markets, particularly those which they would otherwise aggressively pursue. Such legislation constitutes poor international trade policy in this era of global competition for world markets.

Senators, because of the present law, this is what happens when a foreign subsidiary is terminated.

Practically speaking, we cannot bring home income earned from other foreign subsidiaries because it would be subjected to prohibitively high tax rates. This means that those profits will not be available for investment in this country. As a result, costs of operating in the U.S. are higher because money has to be borrowed when it could otherwise have been repatriated, and it becomes difficult to justify the investments needed to remain competitive in foreign markets.

We submit that Section 904(f) of the Internal Revenue Code should be amended to delete foreign termination losses from the foreign loss recapture provisions as a matter of prudent international trade policy.

There is another government imposed handicap for U.S. companies engaged in International Trade. This is the I.R.S. Regulation which requires that a portion of the U.S. expense for research and development be allocated to income earned abroad. This may result in double taxation thereby raising the effective rate of tax on foreign income that may have no relation whatsoever to that research and development. This regulation was intended to benefit the U.S. Treasury, but in the long run it acts as an incentive for U.S. companies to conduct their research and development outside the country. The result is a loss of U.S. jobs and a weakening of our nation's research capacity. This is ironic since in this age of rapid technological change the quality of R & D in this country strongly affects our nation's ability to compete.

S. 1410, introduced by Senators Wallop and D'Amato, and H.R. 2473, introduced by Congressman Shannon and others, recognize this problem. These bills would eliminate the requirement to allocate domestic R & D expenses to foreign source income. We applaud this effort and urge the other members of the Subcommittee on Trade and the Subcommittee on International Finance to support Senator Wallop, Senator D'Amato and S. 1410.

I would also like to touch on the problem of the taxation of U.S. citizens working overseas. I am told that a few years back a number of Hollywood stars avoided U.S. taxes by simply making movies overseas. Congress reacted by changing the tax laws. As a result of this change, however, the United States is the only major industrialized country which taxes its citizens who work and reside in foreign countries. This is true even though they are already taxed, in some cases quite heavily, by their host countries.

Consequently, it has become very expensive for a U.S. corporation to send an American overseas, in part because it must bear the cost of protecting U.S. employees against the burden of this double taxation. Therefore, the recent trend has been for U.S. companies to give overseas jobs to citizens of the host country or to third country nationals. It is simply less expensive to do that than to give these jobs to U.S. nationals.

Foreign competitors do not have this problem. When employing their own citizens overseas, foreign companies can operate more economically than can U.S. companies which employ U.S. citizens in foreign countries. This is just another example of how our tax policy has caused a loss of jobs for U.S. citizens with little offsetting revenue to the Treasury.

The Senate Finance Committee has dealt in part with this problem in its recently reported tax bill. This is a step in the right direction. I urge your support for further Congressional action to completely resolve this problem.

Conclusion

Senators, this joint hearing of the Subcommittee on Trade and the Subcommittee on International Finance testifies to your recognition of the importance of international trade to the well being of the United States and so I will not belabor that point.

In the 1960's, the United States successfully negotiated the removal of tariff barriers to international trade. In the 1970's, we attempted to negotiate the removal of the non-tariff barriers to international trade, although it is too early to tell whether we have been successful.

The next logical step in the 1980's is to remove those barriers that our own government has created - barriers that hamstring and handicap our domestic companies in their attempt to compete in world markets.

Other industrial countries offer direct support and promotion for their domestic companies to expand overseas. We are not asking our government to follow their lead. We are asking that you put us on as even a footing as you can with our foreign competitors.

Lower the tax on U.S. citizens working abroad; support S. 1410 to do away with the allocation of R & D expenses; and amend Section 904(f) so that a company which is forced to terminate a foreign subsidiary is not doubly penalized by recapturing those losses against future foreign income.

Thank you.

Senator HEINZ. Our next witness is Mr. James D. Robinson.

STATEMENT OF HARRY L. FREEMAN, SENIOR VICE PRESIDENT, AMERICAN EXPRESS CO.

Mr. FREEMAN. Mr. Chairman, Mr. Robinson couldn't come. As I explained to staff director on Thursday or Friday, an illness in his family, not him, prevented his coming.

My name is Harry L. Freeman. I am a senior vice president in the office of the chairman.

I am delighted to be here and have this opportunity. I want to introduce Joan Spiro, who is our vice president for trade at American Express.

Joan has been, until recently, U.S. Ambassador to the United Nations, particularly with regard to responsibilities for the economic and social counsul.

Mr. Chairman and distinguished members, I am delighted to be here. Trade and services which we will address, is what we think is the emerging major issue of the 1980's.

The United States has become a service economy and service exports have become the most dynamic part of U.S. trade.

It is time for us to recognize this reality and to develop policies to maintain and improve the competitive position of the United States in trade and services.

It is time for us to concentrate on the trade problems of today and particularly tomorrow, that need handling, instead of the problems of the past. These hearings can be a major step toward a forward looking policy which recognizes the importance of service industries and the need for active congressional participation in that policy.

The data we have on the growing role of services is seriously inadequate. Yet, the statistics that are available show that the United States has moved from an industrial to a service economy and that U.S. exports are increasingly service exports.

Presently, U.S. service industries employ about 7 out of 10 Americans and produce about 65 percent of our GNP.

Turning to trade, U.S. service exports now are estimated to be about $60 billion in 1980; $60 billion. That would be more exports than all of our food and consumer exports together and nearly two-thirds of the capital equipment exports in 1980.

In 1980, services were responsible for the first overall surplus in the balance of payments in the United States since 1976, and total world trade and services now amounts to around $400 billion per year, about 20 percent in world trade.

In my formal statement there is a typo saying it is 50. We are getting toward 50, but it is really 20.

For the moment, the United States is the No. 1 exporter of services in the world. But our position is being challenged. Increasingly we are encountering trade barriers which other countries have erected and continue to expand.

The service sector has not yet received the congressional attention it does merit. For too long the service sector has been overlooked in both domestic and international policy.

What we need to do now, not tomorrow or next year, is to recognize the change in our economic structure in the United States and actively incorporate services into our policy decisions.

In the past and today, trade policy has focused almost exclusively on promoting the export of U.S. goods and on problems with foreign goods flowing into the domestic markets such as cars, steel, and shoes.

These items are very, very important.

This perspective must now shift to add and to include barriers confronting U.S. exports of U.S. services. We can't drop the traditional problems, steel, shoes, and so forth. But we really can't afford to ignore our own future, both categories are essential, growth of services and growth of goods, particularly high technology, go hand in hand. There is a dramatics energy there.

Barriers faced by exporters of services are different from those faced by exporters of goods. They include discriminatory regulations, prohibitive employment laws, and preferential treatment for domestic industries.

This type of discriminatory treatment is a different animal from that which Governments have been accustomed to dealing with in the past. It makes the problem of dealing with services more complex and the need for concerted congressional attention all the more important.

While the United States has some barriers, I can assure you that we are a haven of free trade in services in the world.

Therefore, we need a regime based on reciprocity and equal treatment for all.

What we must really focus on is the fact that service issues and the barriers that discriminate against U.S. operations are genuine trade issues and must be treated as trade issues. This is frequently a matter of perception.

Steel is always considered a trade issue, and rightly so.

Banking is rightly thought of as a banking issue rather than a trade issue when U.S. banks meet restrictions abroad, and they do.

Textiles are always thought of as a trade issue; rightly so.

But when U.S. air carriers meet discriminatory landing fees, discriminatory times when they can land, that is thought of as an aviation issue rather than a trade issue and it is both.

A look at the domestic and international scene reveals that trade and services is emerging as a crucial issue of the 1980's.

On April 9, a few months ago, a Cabinet Advisory Council on Trade Negotiations, chaired by Bill Brock, considered and approved two papers on U.S. policy regarding trade and services.

By this action, the Reagan administration has committed itself to giving high priority to trade issues relating to services, has given the trade representative a mandate to pursue that policy both domestically and internationally.

Last week, before this Committee, Ambassador Brock presented a statement on United States trade policy which recognizes the growing importance of trade and services.

The United Kingdom Government has recently announced an endorsement of the U.S. call for giving high priority to lowering barriers to trade and services.

The OECD, in Paris and the GATT, in Geneva, are beginning to study barriers to international trade and services, including the possibility of how we go about the setting up of a multilateral negotiations on services.

Last month, the ministers of the OECD countries meeting in Paris, agreed that efforts should be undertaken to examine ways and means for reducing or eliminating barriers to trade and services and to improve international cooperation on services.

The GATT consultative group has proposed a ministerial meeting in late 1982. We would hope that such a meeting would have trade and services high on its agenda.

A number of business organizations have gotten active. The business round table has a service sector committee.

The U.S. Consul of the International Chamber and the U.S. Chamber both have service sector committees.

In short, services are coming of age, both in the United States and abroad.

However, I must stress that we are only at the beginning of understanding and grappling with international trade and services.

As this process unfolds, it would be essential for Congress to play a leadership role in the development of a policy.

Some pieces of legislation deserve attention and action. Others will be developed. One pending is a bill introduced by Senators Pressler and Inouye, the Service Sector Development Act which reprioritizes data collection in the Department of Commerce.

This is a very important bill because we are short of data.

Second, we are working on language at the present time. We think the Trade Act of 1974 should be amended in its technical provisions to assure that service sectors are protected in a way where the trade representative, acting for the President, can have the remedies available to handle trade problems that are now available to goods.

We are developing language on that for your consideration.

Existing legislation of the United States Government policy should be strengthened to incorporate the principle of reciprocity in order to give the United States a viable negotiating base.

One area of real need is international communications and in the Senate, the question of how the executive branch should be organized to handle international communications is being considered.

I can't stress the subject of international communications is one of the major industries, is one of the major problems of the 1980's; it already is now.

One of the most important roles Congress can play through oversight is to increase the visibility and awareness of the service sector issues within both governments and the private sector as it is doing with these hearings.

These are very, very complex issues, but we can't shrink because of the complexity. The service sector encompasses everything from advertising health services for export, to banking and insurance, to transportation and tourism.

Only recently have individual service industries begun to think of themselves as part of a larger unit. Unlike the agricultural, industrial sectors, there has been a little analytical work done on services to define the commonality of interests and develop the data base necessary.

This is coming on very rapidly. It was just late last week we got the $60 billion figure I mentioned earlier. The figure before that was $35 billion. I can break that down by industry now.

While recognizing these problems, let me stress that they are not unsurmountable. They require a great deal of time, effort and support from both the private and public sectors in order to deal effectively with obstacles confronting these services.

Thank you very much for your attention and it is a pleasure to be here.

Senator **Heinz**. Thank you very much.

Mr. Freeman, you indicate that the Trade Act of 1974 should be amended to address service sector needs. Do you have any specific language?

Mr. **Freeman**. Well, we are working on language. We are working with Allan Wolf, the former deputy trade representative.

Ms. **Spiro**. If you would like, I can give you some of the suggestions that they were thinking about. The language is not yet developed.

Senator **Heinz**. Well, in order to conserve time, why don't you provide it.

Mr. **Freeman**. We will be happy to submit it for the record.

[The material follows:]

American Express Co.,
New York, N.Y., January 7, 1982.

Ed Daniels,
Senate Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

Dear Mr. Daniels: Following is submitted for the record further to my testimony before the Committee on July 13th of my question from Senator Heinz: "Just what did you have in mind in terms of legislative issues that Congress might address to help U.S. service sector companies abroad?"

Answer: There are many legislative items. My own list would include:

The Service Industry Development Act of 1981 (S. 1233).

The Trade in Services Act of 1981 (shortly to be introduced).

The tax treatment of service industry issues at the GATT Ministerial in November, 1982.

The improvement of service industry statistical techniques by local, state, and federal governments and by international organizations.

The refinement of service industry productivity measurement.

The revision of DISC to include services.

The proposed revision of the job credit, including the provisions of the Urban Jobs and Enterprise Zone Act of 1981 (H.R. 3824) with the intent of offering services tax benefits equal to those received by the manufacturing sector.

Sincerely yours,

Harry Freeman.

Mr. **Freeman**. It is very specific. It is very technical. The whole attempt is to put services on a par with goods.

Senator **Heinz**. Indeed, you have a number of suggestions in that regard.

Mr. **Freeman**. Yes, we do.

Senator **Heinz**. We appreciate the specific suggestions. Thank you very much. I think you put your finger on a problem that a number of people have raised today. I am sure we will give it due attention.

Senator Danforth.

Senator **Danforth**. No questions.

Senator **Heinz**. Senator Dole.

Senator Dole. I have no questions. It is a very excellent statement. It is an area we should address. It is an area we will address.

Mr. **Freeman**. Thank you, Senator Dole.

Senator **Heinz**. Senator Grassley.

Senator **Grassley**. No questions. I will have a chance to read the statement.

Senator **Heinz**. Very well. Thank you very much.

[Statement of Harry L. Freeman follows:]

STATEMENT
of
Harry L. Freeman

Senior Vice President-Office of the Chairman
American Express Company

Before the

Subcommittee on International Trade
of the
Senate Committee on Finance

and the

Subcommittee on International Finance & Monetary Policy
of the
Senate Committee on Banking

on

Trade in Services

July 13, 1981
Washington, D.C.

Mr. Chairman and distinguished members. My name is Harry Freeman and I am a Senior Vice President in the Office of the Chairman of American Express Company.

Trade in services is the major trade issue of the 1980's.

The U.S. has become a service economy and service exports have become the most dynamic part of U.S. trade. It is time for us to recognize this reality and to develop policies to maintain and improve the U.S. competitive position in trade in services.

It is time for us to concentrate on the trade problems of today and tomorrow instead of the problems of the past.

These hearings can be a major step towards a forward looking policy which recognizes the importance of service industries and the need for active Congressional participation in that policy.

The data we have on the growing role of services is seriously inadequate. Yet the statistics that are available show that the United States has moved from an industrial to a service economy--and that U.S. exports are increasingly service exports.

-- U.S. service industries employ seven out of ten Americans and produce 65% of the GNP.

-- U.S. service exports amounted to about $60 billion in 1980--more than exports of all food and consumer goods taken together and nearly two-thirds of capital equipment exports.

-- In 1980 services were responsible for the first overall surplus in the balance of payments position of the U.S. since 1976.

-- Total world trade in services now amounts to $400 billion per year, over 50% of world trade.

For the moment the U.S is the number one exporter of services in the world. However, our position is being challenged. Increasingly we are encountering trade barriers which other countries have erected and continue to expand.

The service sector has not yet received the Congressional attention it merits. For too long the service sector has been overlooked in both domestic and international policy. What we need to do now, not tomorrow or next year, is to recognize the change in our economic structure and actively incorporate services into our policy decisions.

The growing importance of U.S. service exports must be taken into account in U.S. trade policy. In the past and today trade policy has focused exclusively on promoting the export of U.S. goods and on the problems of foreign goods flowing into the domestic market--on cars and steel. This perspective must now shift to include barriers confronting U.S. exports of U.S. services.

Confronting barriers to trade in services wll not be an easy task. Barriers faced by exporters of services are different from those faced by exporters of goods. They include discriminatory regulations, prohibitive employment laws and preferential treatment for domestic industries. This type of discriminatory treatment is a different animal from that which governments have been accustomed to dealing with in the past. It makes the problem of dealing with services more complex--and the need for concerted Congressional attention all the more important.

While U.S. exports of services will grow in the 1980's, trade barriers will expand even faster. Why? Protectionism is on the rise throughout the world and that protectionism will focus on service exports from other countries. Such protectionism will take the form of the subtle non tariff barriers I have described. We must be prepared to anticipate and prevent the rise of such protectionism.

Another challenge to U.S. services in international trade comes from service industries in competitor nations whose governments, for the most part using internationally acceptable practices, do a better job of recognizing, promoting, and defending their international service industries. These governments have recognized what many have tended to take for granted: the major and growing role services can play in their international economic activities. In Japan, for example, service industries enjoy encouragement and support equivalent to that given the manufacturing sector. Japan has the world's second largest service economy. It is simply a matter of time until Japanese service industries penetrate international markets with the same determination they have used in capturing merchandise markets.

I cite this example to demonstrate that neither American services nor American policy operate in a vacuum. There is a vital need to take steps now both domestically and internationally to ensure the continued vitality of our service industries in the international marketplace. What we must really focus on is the fact that service issues and the barriers that discriminate against U.S. operations are genuine trade issues and must be treate as trade issues.

A look at the domestic and international scene reveals that trade in services is emerging as a crucial issue of the 1980's.

-- On April 9, the Cabinet Advisory Council on Trade Negotiations chaired by United States Representative Brock considered and approved two papers on U.S. policy regarding trade in services. By this action the Administration has committed itself to giving "high priority" to trade issues relating to services and has given the Trade Representative a mandate to pursue that policy both domestically and internationally. The Cabinet action is an important milestone in the effort to focus government attention on service sector problems.

-- Last week before this Committee Ambassador Brock presented a Statement on U.S. Trade Policy which recognizes the growing importance of trade in services, indentifies services as an area for priority attention, and commits the Administration to pursue both bilateral and multilateral efforts to deal with trade issues in service.

-- The United Kingdom government has endorsed the U.S. call for giving high priority to trade in services.

-- Both the OECD and GATT are beginning to study international trade in services, including the methods for multilateral negotiations on services.

-- In June Ministers of the OECD countries agreed that efforts should be undertaken to examine ways and means for reducing or eliminating barriers to trade in services and to improve international cooperation on services.

-- Gatt's Consultative Group has proposed a ministerial meeting in 1982 to examine the global trading system. We would hope that such a meeting would have trade in services high on its agenda.

A large part of the credit for this progress is due to U.S. Trade Representative Brock's initiative in promoting service sector issues in various domestic and international discussions.

This survey demononstrates the need for increased Congressional awareness and action on these service sector issues.

The business community has also been very active on service sector issues and has played a vital role in prompting the government to pay more attention to trade in services. Many of the companies providing services of all kinds around the world are recognizing their business problems as trade barriers and are calling for increased government attention to those trade problems.

A number of business organizations have created special committess to monitor and promote service issues.

-The service sector committee of The Business Roundtable, the U.S. Council of the International Chamber of Commerce and the U.S. Chamber of Commerce have been instrumental in bringing service trade issues to the attention of the government and in promoting service sector concerns.

-The International Chamber of Commerce recently sponsored an international roundtable discussion on trade in services. The ICC is in the final stages of completing a policy paper on the liberalization of trade in services.

- -- The advisory committees to the State Department, USTR and Commerce provide direct input into government policy and programs.

In short, services are coming of age both in the U.S. and abroad. However, I must stress that we are only at the beginning of understanding and grappling with international trade in services. Much of the activity to liberize trade in services has occurred in the very recent past, and is only a small indication of the things to come.

As this process unfolds it will be essential for Congresss to play a leadership role in the development of U.S. policy on trade in services.

Several pieces of legislation currently pending before Congress deserve immediate attention and action.

- -- The Service Industries Development Act, S. 1233 and H.R. 3848 now before Congress recognizes, the importance of the service sector and calls for the establishment of a service industries development program within the Department of Commerce. It also gives services higher priority in data collection.

-- The Trade Act of 1974 must be amended to address service sector needs and define remedies applicable to service companies.

-- Existing legislation and U.S. government policies should be strengthened to encorporate the principle of reciprocity in order to give the U.S. a viable negotiating base. One clear area of need is international communications.

-- Congress should rearrange priorities in research and data collection efforts within the Executive branch and academic research programs to develop service related projects.

One of the most important roles Congress can play is to increase the visibility and awareness of service sector issues within both government and the private sector as it is doing with these hearings.

Congress must also exercise its oversight powers in supervising the implementation of service projects within the government.

The issue is not an easy one. Tackling it is both conceptually and practically difficult. The service sector encompasses everything from advertising and education, to banking and insurance, to tourism and transportation. Only recently have individual service industries begun to perceive themselves as part of a larger unit. Unlike the agricultural and industrial sectors, there has been little analytical work done on services to define the commonality of interests and develop the data base necessary to pursue international negotiations.

Furthermore, many of the services such as banking and insurance are regulated by state and/or federal law--causing an even greater fragmentation of the issues and industry cohesion.

While recognizing these problems, let me stress that they are not unsurmountable. It will require a great deal of time, effort and support from both the private and public sectors in order to deal effectively with the obstacles confronting services. By definition this effort will require close cooperation between business and government, between different departments and agencies of the Executive branch, and between the Executive branch and Congress. But given the importance of the service sector today, and the even greater role it will play in the future-- the time to begin this effort is now.

Thank you for your attention. I would be happy to answer any questions you may have.

Senator **Heinz**. I believe we have a couple of distinguished visitors, not from another planet, however, colleagues of ours who have requested the opportunity to appear to discuss a matter of considerable importance.

Senator Mathias and Senator Huddleston, we welcome you to the subcommittees.

STATEMENT OF HON. CHARLES McC. MATHIAS, U.S. SENATOR, STATE OF MARYLAND

Senator **Mathias**. Mr. Chairman, we are jointly honored to appear before this joint session.

I am particularly honored to be here at the witness table with Colonel Huddleston. With his permission, I will make a very brief comment and let him do the hard work.

Senator **Huddleston**. That is normally the way we proceed here, isn't it, with the junior Senator and the senior Senator, at the same time.

Senator **Mathias**. But interstate taxation is a very hard subject to talk about. It is probably an even harder subject to listen about.

So, I am not going to try to belabor this joint hearing very hard on the subject. But it is a question that I have been involved with very intimately for the last 18 years, both as a Member of the House and of the Senate.

The subject itself is one of much greater age. In fact, it was in the 1780's that problems with interstate taxation led to the calling of the constitutional convention which gave the United States the remarkable Constitution under which we have operated now for nearly 200 years.

At that time, we were experimenting with the alliance that was held together by the Articles of Confederation. The taxing by the States of each other's products led to the kind of chaotic economic condition which made the calling of the Constitutional Convention necessary.

We are today plagued by a version of that conduct of States toward each other and toward the rest of the world which has created some very severe conditions.

The U.S. Government itself, like most of the governments of the world, adhere to the arms length method of taxing interstate, international commerce.

The fact that some of the States use the worldwide combination system and apportion dividends, combined with the use of different variations of the method by State jurisdiction, often leads to double taxation. This hurts domestic corporations with overseas subsidiaries, and it causes serious international trade problems in the case of foreign based corporations with the U.S. subsidiaries. When it is used by the States, it invites retaliation against U.S. corporations with operations abroad. It could prompt other countries to adopt it.

So, it has problems for the United States. It has problems of a serious dimension and is discouraging new foreign investment in the United States.

Now, perhaps that is enough to say, at least initially. I will submit the balance of my statement for the record.

Senator HEINZ. Without objection, your entire statement will be a part of the record.

Senator MATHIAS. Thank you.

Senator HEINZ. Senator Huddleston.

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM KENTUCKY

Senator HUDDLESTON. Mr. Chairman, I too appreciate the opportunity to appear before the subcommittee. I think the subject matter of your hearing is very timely and I do believe that while this particular subject might seem somewhat far from your main thrust, it is something that is extremely important.

We do have a confusing situation in the United States in which the Federal Government and several individual States have contradictory policies regarding taxation of corporations which are members of a group of corporations doing business in more than one country.

It is not a new subject. I think the Finance Committee has dealt with it before. There have been a number of hearings and a number of statements made regarding to it in official meetings of various committees of the Congress.

I believe that a resolution of it would certainly enhance the trade policies of the United States and the ability to do business with other companies that might want to trade here as well as in the countries around the world that they are already involved in.

We will then allow the subcommittee to think about lunch and dismiss us, unless you have some further questions.

Senator HEINZ. Senator Danforth.

Senator DANFORTH. Didn't we face this issue with respect to the tax review?

Senator MATHIAS. We did and it was resolved, unfortunately because we struck from the United States-United Kingdom Tax Treaty, the provisions with respect to the unitary tax. That is really the only time in which we dealt with this.

I am delighted with this joint committee approach because I think you are going to be able to look at the whole depth of this problem now.

When I was a member of the old Willis' Subcommittee or Special Committee on State Taxation of Interstate Commerce, in the House of Representatives, we really only heard from State taxing officials. State taxing officials were concerned about their theoretical jurisdiction and they were concerned about some of the practical effects on the level of State revenue. Those are proper concerns.

But there are other—and I think there are other good answers to those concerns—but in addition to that, there are other considerations here as Governor Brown has found in California, the opportunity to attract new business to California which would be substantial, is being jeopardized in a very serious way by the fear of the investors that their worldwide operations are going to be subjected to the local taxation of California and therefore, all of the efforts of the economic development branch of State government are being negated by the concerns created by this tax problem.

Governor Thornburg of Pennsylvania, has expressed himself on the record, in much a similar fashion. A State which is making a big effort with the assistance of its senior Senator, to develop economically, but will face serious impediments to an economic development program with the tax law in the present State that it is.

So, I think it is a very healthy thing that there is this dual committee examination which will look at the full depths of the problem.

Senator HUDDLESTON. If I might inject there, this was a matter of some concern in the British Parliament when they were considering the ratification of the agreement between the two countries.

I might quote what one member of the House of Commons pointed out, Roger Moden. He said, talking about the worldwide combined reporting being used:

> It is a bad international precedent for the British Government or any other nation to have to look to perhaps 50 States in the United States for an understanding of the way in which we are to conduct our internal or international tax affairs. That cannot be right. I am sure that the United States understands that this is a grossly unsatisfactory situation. It is a bad international precedent because of the damage it could do to all world trading nations.

So, this is not something that has a limited application. It is and could be a very major problem for trade with the United States.

Senator DANFORTH. Gentlemen, it is an interesting question. Thank you very much.

Senator MATHIAS. Thank you.

Senator HUDDLESTON. Thank you.

[Statement of Senator Charles McC. Mathias follows:]

STATEMENT OF SENATOR CHARLES MCC. MATHIAS, U.S. SENATOR FROM MARYLAND

I am delighted to appear before the International Trade Subcommittee and the International Finance and Monetary Policy Subcommittee to talk about the problems of state taxation of interstate and foreign commerce. Any study of foreign trade must address the tremendously important question of taxation of companies that do business across national boundaries. As many of you know, I have been pursuing legislation in this complex area throughout my 20 year career in Congress.

But the interstate tax issue has a much longer lineage than my 20 years. In fact, back in the 1790's, interstate taxation led to the calling of the convention that in the end drafted our Constitution. At the time the United States was experimenting with a loose alliance under the Articles of Confederation. Back in that period, the states taxed interstate commerce to the point where this commerce practically dried up, and the Founding Fathers' idea of a national economy, in which everyone prospered, never got off the ground.

Of course, the Constitutional Convention moved on to many other important topics, but the original impetus that led to the convention in Annapolis of the independent state commonwealths was prominently reflected in the commerce clause in Article I: "The Congress shall have the power to regulate commerce with foreign nations and among the several states, and with the Indian tribes." So it is entirely appropriate that this issue from the 1780's is at the top of the news again in the 1980's.

Interstate taxation is a hard subject to talk about, and it's a hard one to listen to somebody else talk about. But it's so important, I continue to talk and I continue to find audiences willing to listen.

S. 655 deals with the unitary method of taxation by worldwide combination, currently used in varying degrees by several states. Under this method, the states can tax companies doing business in interstate and foreign commerce on the basis of their aggregate worldwide income, rather than on that portion of it that comes from activities with in the taxing state.

I'd like to make clear at the outset that my bills will in no way limit the right of the states to impose whatever level of taxation they want on business within their jurisdictions. They are in no way contrary to the notion of states rights. Instead, my bills would simply make sure that the individual states tax only the money earned within that state's boundaries, either directly or indirectly. In that way, business would avoid the threat of double taxation, and we will eliminate confusion by bringing the state practice into conformity with the arm's length method used by the federal government.

As you know, the federal government treats the subsidiaries and affiliates within a corporate group as separate entities for tax purposes; it imposes a tax only if and when the overseas income is repatriated to the United States. By contrast, some states extend their tax jurisdiction to foreign source income whether or not it has been repatriated. Also, in the case of intercorporate dividend payments, they disregard taxes already paid in the home country where the divident income was generated, while the federal government allows a credit for any foreign taxes paid on these earnings before the time of transfer. Some states do this even for non-American companies, and these conflicting policies have led to a great deal of confusion and hard feelings among our foreign trading partners.

In the first place, compliance with the reporting requirements of the states using a worldwide combined reporting system entails elaborate record-keeping operations. Many international corporate tax counsels now preside over immense accounting divisions that do nothing but keep track of the tax requirements of state and local authorities oceans away. We should not underestimate the resentment felt by these foreign-based firms at having to assemble and deliver up meticulous operating records to the American state governments that are not required by the legal authorities in their own home territory, and that they would not otherwise bother to keep. My impression is that the objection to this record-keeping imposition by the states in many cases looms larger in the eyes of our overseas trading partners than any financial loss.

Nearly all the governments of the world market adhere to the arm's length method practiced by the U.S. government for taxing international commerce. The fact that some of the states use the worldwide combination system and apportion dividends, combined with the use of different variations of the method by different state jurisdictions, often leads to double taxation. This hurts domestic corporations with overseas subsidiaries, and has caused serious international trade problems in the case of foreign-based corporations with U.S. subsidiaries in the states employing worldwide combination. Its use by the states invites employing worldwide combination. Its use by the states invites retaliation against U.S. corporations with operations abroad, and could prompt other countries to adopt it. And, plainly, it discourages new foreign investment in the United States.

The disincentives to investment are costing our country jobs. Many corporations have decided not to locate subsidiaries in California, for example, because of concern over that state's taxing methods. I don't want to fault the state tax administrators, who understandably have a narrow view of revenue maximization, but let me quote from testimony presented on behalf of the Governor of California by California's Secretary of the State Business and Transportation Agency.

We are on the verge of substantial new investment from foreign firms, particularly if the unitary tax is modified. The expected revenue loss * * * would be recovered many times over through new capital investment and job creation resulting from the expanded operations in the state.

I heard this testimony only minutes after the California tax administrator opposed the bill as detrimental to the state's interests. I mention this only by way of illustration of the complexity of the issue we face. But we can no longer afford antagonism between business and government on this issue. The time has come to raise the level of the debate and talk frankly about the larger issues—about jobs, the national interest, and economic survival.

The Chairman of Lloyd's Bank of California stated: "Many businesses have failed to locate in California because of the danger of the application of the unitary tax. Others, including the Hong Kong and Shanghai Bank, have considered withdrawing from California because of it."

The tax manager of B.A.T. Industries of London said: "* * * B.A.T. believes that the continuance of the present tax system will inhibit new investments in California * * *. In our own case, we have looked at locating a paper processing plant in California and decided against doing so and in fact located in the State of Pennsylvania, where the capital cost of the plant is $15 million." Pennsylvania refrains from using the worldwide combination approach, and also exempts from state taxation all foreign and domestic dividend payments to corporations within the state that are included in the federally taxable income. As a matter of fact, I have a letter of support from Governor Thornburgh of Pennsylvania, which I would like to make a part of the permanent record.

In this regard, I was pleased to note that the President's Transition Team this winter endorsed the intention of my bill. Treasury wants to protect U.S. companies against unjustified state taxation of foreign source income of their subsidiaries, and to attract foreign investment in the United States by protecting foreign-owned companies against unreasonable state income tax burdens.

The timing may be just right for action this year. The states have always worried about losing revenue, especially during these economic hard times. I think they're wrong, as I've said; in the long run, they'll come out ahead. But this year we will enact major federal business tax cuts. This means that the states will get substantially more money. Profits will increase with a smaller federal tax bite, and the states will have a bigger pot to share.

I want to reiterate that my bill would in no way limit the right of the states to impose whatever level of taxation they choose on business that is conducted within their jurisdiction. My cosponsors and I are only trying to make sure that the states, in deference to our federal system of government, tax only income that is earned within their boundaries. They may freely choose to impose any tax they want on this income, and not be in conflict with our bill, so long as they tax income that is earned within their state or that derives from outside operations with a direct, organic connection to operations within their state.

I hope you will agree that my bill responds to genuine problems, and that there is a mutuality of interest between the states, businesses of all sizes, and the American taxpayers in settling this issue. I would welcome your comments on my bill, and would be pleased to answer any questions.

COMMONWEALTH OF PENNSYLVANIA,
Harrisburg, Pa., May 27, 1981.

Hon. CHARLES McC. MATHIAS, Jr.,
U.S. Senator,
U.S. Senate, Washington, D.C.

DEAR SENATOR MATHIAS: I have received your letter concerning S655, your interstate tax legislation for this session of Congress.

I asked the Secretary and Deputy Secretary of the Department of Revenue for their comments on S655. They informed me that the passage of this bill will not adversely affect the Commonwealth of Pennsylvania presently or in the foreseeable future.

The bill would forbid states from requiring corporations to report income on the so-called "Worldwide Combination" method. It would also limit state taxation of foreign source dividends to that portion effectively taxed by the Federal Government. The result of this legislation would, in our opinion, help return some preciously needed capital to the investment cycle in the United States.

Pennsylvania has historically treated and taxed corporations as separate legal entities. Under the Corporate Income Tax, Capital Stock and Franchise Tax, the separate entity concept has been followed consistently. Pennsylvania also does not tax dividends received by corporations, and we doubt these taxing concepts will be legislatively changed.

I agree with you that your bill responds to genuine problems and that there is a mutuality of interest between the states, business and the American taxpayers in settling this issue.

With best wishes.

Sincerely,

DICK THORNBURGH, *Governor.*

Statement of Senator Walter D. Huddleston

For

Hearings on United States Trade Policy

United States Senate

Committee on Banking

Subcommittee on International Finance &

Monetary Policy Subcommittee

Committee on Finance

Subcommittee on International Trade

July 13, 1981

Mr. Chairman, Members of the Subcommittees, I appreciate the opportunity to appear before you. You are to be commended for your joint inquiry regarding United States trade policy. I would like to point out one area that deserves special legislative attention if a trade policy is to be developed without adverse impact. That is the present confusing situation in the United States in which the Federal government and several individual States have contradictory policies regarding taxation of corporations which are members of a group of corporations doing business in more than one country.

In administering the Federal tax laws, the Internal Revenue Service has adopted the arm's length standard for apportioning income between related domestic and foreign corporations. The regulations implementing IRC section 482 could not be more straightforward. For the purpose of the Internal Revenue Code "true taxable income" means, in the case of a controlled taxpayer, the taxable income which would have resulted if the controlled taxpayer had, in the conduct of its affairs, dealt with the other member or members of the corporate group at arm's length. 26 C.F.R. Section 1.482-1 (a) (6)

The arm's length, separate accounting, separate enterprise principle has been adopted in nearly forty income tax treaties which the United States has negotiated. This international stance of the United States has also been evidenced in approximately twenty-five treaties of friendship and commerce into which the United States has entered with foreign nations.

The arm's length method has also been adopted and recommended as the standard by the Organization for Economic Cooperation and Development of which the United States is a member. The Council of the OECD in July 1979 recommended that the arm's length method, rather than any formula apportionment method, be used uniformly worldwide.

In the United States many corporations do business in more than one State. A majority of States use an apportionment formula to assess the tax liability of the unitary operations of a single multistate corporation. A substantial number of States apply an apportionment formula to a group of corporations when the operations and management of the group are unitary in nature, i.e., integrated to engage in one business or have related business purposes. That application is called the "unitary method" of taxation.

California, Alaska, Idaho, Montana, North Dakota, and Oregon apply unitary apportionment to the worldwide operations of foreign affiliates of United States corporations, even when those corporations are involved in non-unitary or unrelated lines of business and are not conducting business in the taxing State, or even in the United States. This unwarranted enlargement of the unitary method to worldwide operations of affiliated corporations has become known as the "worldwide combined reporting system."

Limitation of the use by the States of the worldwide combined reporting system was first proposed in the United

States-United Kingdom Income Tax Treaty which the Senate considered and adopted in 1979. The limitation which would have established that only the arm's length method would be used in assessing the taxes of United States corporations with British parents was removed by reservation so that a legislative solution to the entire international tax problem could be addressed.

In the 96th Congress identical bills were introduced to limit the use of the worldwide combined reporting system by the States, H.R. 5076 and S. 1688. The limitation proposed by the legislation was in accordance with the recommendations of the Task Force of Foreign Source Income of the House of Representatives Committee on Ways and Means which had in 1977 studied taxation of multijurisdictional corporations.

On March 31, 1980 hearings were held on H.R. 5076 before the Committee on Ways and Means. The record, Serial 96-81, is 395 pages long. On June 24, 1980 our good friend Senator Byrd of Virginia chaired hearings before the Senate Committee on Finance, Subcommittee on Taxation and Debt Management Generally on S. 1688 and other related bills, the record of which encompassed two volumes, H.G. 96-87.

I call the Subcommittees' attention to those hearing records as they contain excellent statements which clearly establish the need to limit the use of the worldwide combined reporting system. I would appreciate having included in the record of this hearing as an attachment to my remarks the oral and written statements of John S. Nolan who testified before the Subcommittee on Taxation and Debt Management Generally on behalf of the International Chamber of Commerce and Roger Kirk, Vice-President of Brown & Williamson Tobacco Company, Inc. Those statements are found on pages 89-162 and 665-683 of the hearing record respectively.

Though these statements and the record clearly establish why the individual States should not be permitted to make their own policies on taxing international commerce through the use of the worldwide combined reporting system the following from the statement of the Unitary Tax Campaign at the June 24, 1980 hearing provides a good summary:

> ...there can be no reasonable justification for a tax system which:
>
> (a) apportions income on the basis of any one or more of a number of factors not necessarily directly related to actual income and the expenses of the business;
>
> (b) taxes income outside of and not in any way related to the taxed companies' operations;
>
> (c) uses bases and factors which can be and are varied by the tax authorities from year to year;

(d) calls for accounts and information on a basis totally different from any other tax system and even beyond the kind of information readily available to an international trading company, except at unacceptably huge additional costs;

(e) with separate tax authorities using the same basic method, but with different factors and definitions in their calculations, can lead to multiple-taxation - even of extra-territorial income;

(f) could, for example, place a U.S. company in the impossible position of being requested to disclose classified information on the details of its operations when the group or part of it is involved in the defense equipment industry;

(g) is difficult to administer and is an inaccurate method of apportioning the income of multinational businesses among taxing jurisdictions;

(h) may result in the State taxing income of the multinational enterprise that is not derived from or substantially related to the operation of an affiliate of the enterprise in the taxing State;

(i) to produce equitable results requires equality of factors combined, when cases of truly unitary entities with equal rates of profit, property, and labor, occur seldom if ever in the context of multinational business;

> (j) is not only unfair, but also impedes industrial investment and decreases job opportunities as a result. Hearings before the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance on S. 983 and S. 1688, June 24, 1980. HG 96-87 p. 595.

The International Chamber of Commerce, having considered the abuses of the worldwide combined reporting system issued a resolution on September 26, 1979 recommending:

> ...in all cases where the taxation policies of political sub-divisions extend to non-domestic operations, all possible measures should be taken to ensure that the terms of an agreement or treaty dealing with taxation on income should bind all authorities having jurisdiction within the boundaries of each contracting State. This recommendation is in accordance with the OECD Model Taxation Convention, 1977 (Art. 2) and a considerable number of international friendship, trade and shipping treaties.

The nine governments which make up the European Economic Community have indicated their strong arguments against the worldwide combined reporting system. England, France and Canada have added strong reservations to their recently negotiated treaties with the United States expressing disapproval of the worldwide combined reporting system and calling for limitation of it at the earliest possibility.

The International Chamber of Commerce, Chamber of Commerce of the United States, the American Chamber of Commerce in Great Britain, the Business Roundtable, the National Association of Manufacturers, the Committee of State Taxation of the Council of State Chambers of Commerce, the Confederation of British Industry, the Dutch Employers Federation, the German American Chamber of Commerce and most of the major companies in this country and Great Britain which provide employment for millions worldwide, all have expressed support for such limitation.

Roger Moate, Member of the House of Commons pointed out during the consideration by the House of Commons of the Income Tax Treaty between the United States and the United Kingdom that not only England should be concerned regarding the possible spread of the use of worldwide combined reporting:

> It is a bad international precedent for the British Government or any other nation to have to look to perhaps 50 states in the United States for an understanding of the way in which we are to conduct our international tax affairs. That cannot be right. I am sure that the United States understands that this is a grossly unsatisfactory situation.
>
> It is a bad international precedent, because of the damage that it could do all world trading nations. Page 194, February 18, 1980, Hansard.

As this Subcommittee hears testimony on United States trade policy it should keep in mind the urgent need to provide the United States with one policy regarding the taxation of United States corporations with affiliates overseas. The United States has established its policy regarding taxation of such corporations. That policy is not the worldwide combined reporting system. The result of these hearings should be a recognition that it is essential to limit the use of that vexatious taxing method by a few States which is contrary to national policy.

Thank you.

Senator **Danforth**. The final witness is Susan L. Snyder.

STATEMENT OF SUSAN L. SNYDER, PRESIDENT, PATHFINDER CORP. FOR INTERNATIONAL TRADE

Ms. **Snyder**. My name is Susan Snyder. I am accompanied today by Richard Paren, who is counsel for Pathfinder. He is with Dickstein, Shapiro & Morin.

I am president of the Pathfinder Corp. for International Trade, a firm specializing in export trade and overseas business development.

Our clients include companies of all sizes; the majority come from Europe and the United States.

Before founding Pathfinder, I worked abroad for 8 years for a major foreign-owned multinational corporation, first as a market strategist for development and diversification and then as head of a subsidiary company's world-wide export organization.

My comments to you today are made in the context of this firsthand operational experience. As a result of my work overseas, I am a strong proponent of free trade in world markets.

It is gratifying to see the attention being focused on International Trade by the Finance Subcommittee on International Trade and the Banking Subcommittee on International Finance and Monetary Policy.

It is to be hoped that these hearings will help define a pragmatic, vigorous trade policy.

Does the United States have or need a comprehensive trade policy?

I think the record speaks for itself.

In 1960, the United States occupied 25 percent of world trade in manufactured goods.

In 1970, American's share declined to 21 percent.

In 1980, not only had this share diminished to 18 percent, but the United States lost its position of world leadership in manufactured exports.

Ironically while the American trade position declined, foreign trade entered a boom trend. Dominating two-thirds of international commerce in manufactured goods, the leading industrial countries logged an impressive 563 percent mean increase in trade from 1970 to 1980.

Individual trade performances were as follows.

Japan led the way in growth. Its market share increased 2 points.

Germany increased its market share 1 point, to take world leadership in the share of manufactured goods.

The U.S. share has slipped 3 percentage points.

The United States failed to keep pace with the growth trend. It fell into second place behind Germany and finished a distant second after the European Community.

The failure was costly. If the United States had maintained its initial market position, it would have entered an additional $57 billion in export sales. That amount would have eased foreign payment deficits and contributed to employment and business prosperity.

With the decline in the American export share, a new trade order emerged. The least that can be said is that American trade policy was ineffective.

The new trade order was not a random occurrence. It came about through careful planning. The resulting trade strategies centered on efforts to:

Stimulate business to seize export opportunities.

And to foster conditions to favor intra-regional trade.

Foreign governments, with active business participation, initiated these measures. Their vigorous and timely implementation resulted in the successful trade performances of the 1960's and 1970's.

International competition is fiercely aggressive. Policies formulated to increase exports provided concrete business incentives to exporters. The stimuli were offered in the form of comprehensive fiscal, financial and technical assistance.

An inventory of industrial countries trade-related policies reveals a panoply of export incentives. In financing there are competitive loans, some starting at 7.5 percent and covering 80 to 100 percent of contract value and lenient repayment terms are found in most of the countries leading the export trade growth.

Insurance, with protection against usual industrial, commercial and political risks is also made more competitive with market development, exposition and inflation risk included in the insurance policies.

Taxation incentives included substantial tax breaks for foreign branch subsidiaries, dividend income and deferred taxation on local income for market development and foreign business losses.

Another form of incentive was instituted by governments directly and target markets to create conditions favorable to their exporters. These incentives took the form of trade support with bilateral trade and development accords.

The three leaders in the growth of the 1970's were Japan, France, and Germany. Interestingly, they also led the way with aggressive, innovative trade policies.

To the trade analyst, these incentives are potentially troublesome. For the American practitioner, they present real obstacles to selling overseas. Highly competitive terms of finance, insurance covering inflation and business losses during the long leadtime needed to pursue large international contracts, bilateral loans stipulating purchase quotas of material manufactured in the country providing the loans, tax incentives for export market development and exemptions for earnings overseas, all this sophisticated trade weaponry radically disadvantages American exporters in international competition.

International competition is becoming increasingly structured. The strategic response overseas to heightened world competition was to foster broad-based, homogeneous organizations to create and pursue trade opportunities.

The formal regional market concept of the 1950's was transformed during the past decade into loosely constructed trade communities. Although it counts 10 members, the European economic market effectively covers the continent. Free trade agreements negotiated between the EEC and nonmember European countries now constitute an operationally inclusive market.

In the Far East, an informal regional market functions with preferential tariffs accorded by Japan to its lesser developed Asian neighbors.

Manufacturers' groups have organized within this regional framework. Approximately 600 such organizations participate actively in foreign trade. They have taken the form of trade associations, trade combinations, export clubs, technical standards conferences, or Government-industry syndicates.

Increased organization in the world marketplace is a function of industrial development and specialization. Manufacturers' groups promote industrial expansion. Regional markets strengthen local economies and encourage growth.

Nevertheless, the aggressive tenor of international commerce and the deterioration of the United States' trade position also point to the direct use of regional markets and manufacturers' combinations to limit American competitivity.

Foreign trade is essential to the U.S. economic interest. In my opinion, an improved trade balance is a precondition to the success of the Nation's economic programs. This improvement must be achieved principally through exports.

The world market system has moved to a stage midpoint between fragmented protectionism and GATT normalization; namely, it is dominated by foreign regional and industrial organizations.

Business is transacted in the realm of the feasible. Individual business will have extreme difficulty competing in this environment. Except for the few industrial super-giants, corporate entities are not equipped to deal with foreign governments or their instrumentalities. Industry combinations acting in concert to control trade are a breach of U.S. law.

In consequence, active Government participation is needed to achieve free trade. United States trade policy should be mobilized to deregulate institutional and de facto obstruction to American competition in foreign markets.

The Export Trading Company Act and the Foreign Corrupt Practices revisions will be helpful in improving American trade competitivity.

Further, the practical reality of the international trade contest calls for an improved incentive system to encourage exports.

Although export is ultimately profitable, it is expensive and risky up front. The most effective incentives for healthy businesses seeking sales abroad would involve expanded measures to hedge against loss. These incentives should include insurance covering market development risks and tax measures providing deferral for overseas market development applied to taxation of domestic income.

In formulating a profitable trade policy, the United States need not exhaust its political and commercial resources to develop a compendium of trading laws. Rather, it should implement specific measures strategically targeted to help get export results.

I am a trade strategist. Our trading partners are fighting a good fight; they have a strong offense backed up by a solid defense. In private conversations they indicate that they have long expected the United States to rise to the trade challenge. They fully understand the just standard of reciprocity in trade matters. In furthering their interests, they have moved beyond the limits of reciprocity.

The alarming aspect in the U.S. present trade position is the consistent passivity apparent in U.S. trade performance during the decline. This lassitude does not appear among our principal trading partners, who have been persistently active.

Their aggressiveness and superior results reflect their knowledge of the value of trade tactics. They have acted accordingly.

I urge the United States to do likewise.

Senator HEINZ. Ms. Snyder, I am sorry to miss some of your statement. But, what I heard was excellent.

I do note that you have called for some specifics in financing, insurance, and taxation. Are there any other means that are at our disposal that we should use to insist upon reciprocity, more openness to other markets?

Ms. SNYDER. Well, the tenor of international competition that brought about the present trade order has substantially undermined the trade normalization efforts of recent years. The lagging U.S. trade record results in part from that fact. I think we need to show our trading partners that we are serious about correcting this problem.

The United States should try to neutralize de facto obstruction to its trade competitiveness. It should also be prepared to implement measures that would be competitive with its trading partners' practices.

Senator HEINZ. So you see it principally as a matter of will if the Reagan administration or before it, the Carter administration, any of our administrations, had the will, they could by virtue of the strength we have internationally, batter down all these barriers; is that right?

Ms. SNYDER. "Batter down" sounds severe.

The policy that has been pursued to move toward trade normalizaiton is positive. Unfortunately, we have not shown our trading partners that if they do not adhere to their commitments in action as well as in word, they will have a great deal of trouble with America in trade competition.

Senator HEINZ. What kind of trouble will they have? Will we erect high barriers? Will we keep them out of our market?

Ms. SNYDER. In extremis. Since I view trade barriers as a radical solution to be applied only in case of a radically exacerbated problem, I prefer an approach that stimulates U.S. trade activity abroad. I would like to see American business become more agressive in the international marketplace.

That is why I have suggested in my statement that measures be implemented to encourage American business to compete actively overseas and to have at its disposal trade weapons equal to those its competitors are using.

Senator HEINZ. But is there any pressure that we can place on the Japanese or the French or the Canadians that isn't protectionistic in a sense, as leverage?

Ms. SNYDER. I don't believe that implementing improved insurance coverage for exporters is a protectionist policy.

Senator HEINZ. No, it is not. I agree with you.

Ms. SNYDER. I have not advocated protectionist policies. Leverage can be gained by entering foreign markets in strength with convincing trade skill.

Senator HEINZ. Thank you very much.

Senator Danforth.

Senator DANFORTH. I think you presented a very good statement. It is very well thought out. As I understand it, the lassitude and aggressiveness you are talking about is aggressiveness in exporting policy.

That is, you advocate we do a better job in encouraging exports through governmental policies.

Ms. SNYDER. Yes. I believe, however, that those policies should be designed to stimulate American trade activity, and they should put U.S. business on even footing with foreign competitors in international trade practice. I think the institution of protectionist measures might be counted among the weapons that the United States would prefer not to use but must nevertheless keep ready in its trade arsenal

Senator DANFORTH. You would agree with the administration's policy on safeguards?

Ms. SNYDER. You mean a kind of trigger mechanism?

Senator DANFORTH. Orderly marketing agreements.

Ms. SNYDER. Yes.

Senator DANFORTH. That is, you essentially propose that if an industry in the United States is very shaky and looks as though it is in very bad shape, your advice would be to basically follow the administration's policy, taking a dim view of orderly marketing agreements.

Ms. SNYDER. Included among our clients is a group of manufacturers in an import-injured industry sector. Pathfinder is working at the trade association level.

We have conducted direct market research overseas. We know these same manufacturers could be competitive as exporters. However, we do not think they will be able to go overseas and compete where they could succeed without some form of trade incentive.

Operating in a mature industry sector, these companies need stimulation to enter foreign markets. They don't need to languish in a fortress; on the contrary, they should be encouraged to venture forth and develop an international business base.

Senator **Danforth**. The first point the administration made in the White Paper was that the economic recovery program would be helpful to American business and help our trade picture.

But they made it clear that they do not advocate an industry-specific program, whereas the Japanese provide special economic incentives for industries that they anticipate will be very competitive in international markets; semiconductors, for instance.

Ms. **Snyder**. Yes.

Senator **Danforth**. Our administration has indicated that they don't agree with that approach. They don't want an industrial policy. What they want to do is allow market forces to work. Would you favor a more aggressive position for our Government in singling out specific industries which offer hope for being competitive and providing special targeted tax breaks and other incentives for those industries?

Ms. **Snyder**. That is a difficult question. Success engenders imitation; and in this case, the Japanese certainly seem to have found a successful formula. May I add that Japan is not the only country providing such aid. Many European countries are providing direct aid to industries they have targeted for growth. There the results are mixed.

I would like to see incentives that encourage industries to be active and competitive overseas rather than direct subsidies that bestow financial favor on an anointed sector. Agressive growth industries would logically use general trade incentives to attain international stature.

Senator **Danforth**. You don't have any position on that one way or the other?

Ms. **Snyder**. No policy formulation before other governments' planned industrial development on an international scale is a policy in itself. Companies are not the only ones competing. In reality, governments are competing as well. The U.S. Government must also be effective in stimulating American business to improve upon or develop international trade activities.

The nature of the de facto obstructions to American trade requires U.S. Government action to remove external constraints. Government policy to encourage trade through the form of tax incentives or indirect stimuli, such as export insurance, would also be very helpful.

Given the hard reality of international competition and the small likelihood of negotiating another order, these measures are minimal and practical; and, to my mind, they remain outside the domain of protectionism.

Senator **Danforth**. I am not clear exactly how you are coming out on this. You do think if we don't do something we are just going to lose.

Ms. **Snyder**. We have already lost ground. If we do nothing, we are going to continue to lose, definitely.

Senator **Danforth**. But you don't want to be so specific that you are just taking industry and giving the money to it.

Ms. **Snyder**. That's right. I am sugggesting a dual approach. I recommend the implementation of benefits that encourage industry to enter and stay active in international trade competition.

I see an important option in the possibility of negotiating to remove the heavy odds against American business in international trade proctice. It is essential in negotiations, especially international negotiations, to go to the bargaining table with a strong hand. As I mentioned earlier, business alone is not capable of dealing effectively with foreign governments and their instrumentalities. U.S. Government participation in these efforts must be maintained if American trade performance is to be improved.

Senator **Danforth**. Senator Grassley.

Senator **Grassley**. Thank you, Mr. Chairman.

I concur with my colleague's analysis and agree with her constructive comment of your paper. I want to know your perception or your view of the perception, as you quote here, our trading partners are fighting a good fight. These industries and governments overseas that are fighting this good fight, their perception of why America has kind of been second in world trade or have not come on as strong as they anticipated we would.

Do they perceive that as being a planned policy of our Government or do they see that as, in other words, something we don't mind happening or do they see that as kind of something that has just happened because we aren't consciously on top of foreign trade as we ought to be?

Ms. **Snyder**. Generally, their perceptions fall in the latter two categories. They feel that foreign trade is not as important to our economy, or has not been as important to our economy, as it is now becoming. For countries with smaller interior markets than the United States, and this includes most of America's industrialized competitors, foreign trade has long been a priority target. In some of the press that has accompanied these hearings, mention was made of the percentage that foreign trade occupies in our GNP.

If you look at the leading trading countries listed earlier, the share of foreign trade within total GNP is two and three times greater than that found in the United States.

In order to survive, in order to balance trade payments and to continue their social programs, for example, these countries have pursued foreign trade with a vengeance.

So, your last point is fundamental.

Moreover, I think our trading partners believe that Americans in an international context are more generous, more relaxed, less competitive, than are their foreign equivalents. We don't counterattack until we are seriously aroused.

Senator **Grassley**. Do they express confidence that if we did decide to be aggressive, that we would overcome?

Ms. **Snyder**. Oh, yes. They are afraid of that. I attended a meeting recently with leading Japanese businessmen. During the proceedings, they cited the adage of the elephant, a large but lumbering entity like America, and the dog, small but agile like Japan. They observed that the dog has better be careful not to exasperated the elephant or he will have trouble.

Their strategy is to maintain basically friendly industrial relations with the United States and try not to let matters arrive at a breaking point.

Senator **Grassley**. Thank you.

Senator **Danforth**. Ms. Snyder, thank you very much. Your testimony was excellent and very helpful.

That concludes the hearing.

[Whereupon, at 12:38 p.m., the hearing adjourned, subject to the call of the Chair.]

STATEMENT OF

SUSAN L. SNYDER
PRESIDENT, PATHFINDER CORPORATION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE
COMMITTEE ON FINANCE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

JULY 13, 1981

STATEMENT ON UNITED STATES TRADE POLICY

Mr. Chairmen and members of the Subcommittees:

My name is Susan Snyder. I am President of the Pathfinder Corporation for International Trade, a firm specializing in export trade and overseas business development. Our clients include companies of all sizes; the majority come from Europe and the United States.

Before founding Pathfinder, I worked abroad for eight years for a major foreign-owned multinational corporation, first as market strategist for development and diversification and then as head of a subsidiary company's world-wide export organization.

My comments to you today are made in the context of this firsthand operational experience. As a result of my work overseas, I am a strong proponent of free trade in world markets.

It is gratifying to see the attention being focused on international trade by the Finance Subcommittee on

International Trade and the Banking Subcommittee on International Finance and Monetary Policy. It is to be hoped that these hearings will help define a pragmatic, vigorous trade policy resulting in substantial improvement in U.S. trade performance.

I. DOES THE UNITED STATES HAVE OR NEED A COMPREHENSIVE TRADE POLICY?

The trade record speaks for itself:

1960 - The U.S. occupied 25% of world trade in manufactured goods.

1970 - America's share declined to 21%.

1980 - Not only had this share diminished to 18%, but the U.S. lost its position of world leadership in manufactured exports.

Ironically while American trade declined, foreign trade entered a boom trend. Dominating two-thirds of international commerce in manufactured goods, the leading industrial countries logged an impressive 563% mean increase in trade from 1970 to 1980.

Individual trade performances were as follows:

	% Growth	Market Share	
		1980	Change 1970-80
Japan	+ 656	11	+ 2
France	+ 600	10	+ 1
Germany	+ 539	21	+ 1
United Kingdom	+ 506	10	- 1
United States	+ 469	18	- 3

Source: U.S. Department of Commerce

The United States failed to keep pace with the growth trend. It fell into second place behind Germany and finished a distant second after the European Community.

The failure was costly. If the United States had maintained its initial market position, it would have entered an additional $ 57 billion in export sales. That amount would have eased payment deficits and contributed to employment and business prosperity.

With the decline in American exports, a new trade order emerged. The least that can be concluded from this event is that United States trade policy was ineffective.

II. THE CHALLENGE TO AMERICAN TRADE POLICY: A NEW TRADE ORDER

The new trade order was not a random occurrence. It came about through careful planning. The resulting trade strategies centered on efforts to:

- stimulate business to seize export opportunities,
- foster conditions to favor intra-regional trade.

Foreign governments, with active business participation, initiated these measures. Their vigorous and timely implementation resulted in the successful trade performances of the 1960's and 1970's.

A. The Tenor of International Competition

Policies formulated to increase exports provided concrete business incentives to exporters. The stimuli were offered in the form of comprehensive fiscal, financial, and technical assistance. An inventory of the industrial countries' trade-related policies reveals a panoply of export incentives:

Financing:	competitive loans, some starting at 7.5% and covering 80-100% of contract value, lenient repayment terms.
Insurance:	protection against usual industrial, commercial, and political risks plus market development, expo, and inflation risks.
Taxation:	substantial tax breaks for foreign branch, subsidiary, dividend income; deferred taxation on local income for market development, foreign business losses.

Another form of incentive was instituted by governments directly in target markets to create conditions favorable to their exporters:

Trade supports: bilateral trade and development accords.

The three leaders in trade growth of the 1970's were Japan, France, and Germany. Interestingly, they also led the way with aggressive, innovative trade policies.

To the trade analyst, these incentives are potentially troublesome. For the American practitioner, they present real obstacles to selling overseas. Highly competitive terms of finance, insurance covering inflation and business losses during the long lead time needed to pursue large international contracts, bilateral loans stipulating purchase quotas of material manufactured in the country providing the loan, tax incentives for export market development and exemptions for earnings overseas, all this sophisticated trade weaponry radically disadvantages American exporters in international competition.

B. The Structure of International Competition

The strategic response overseas to heightened world competition was to foster broad-based, homogeneous organizations to create and pursue trade opportunities.

The formal regional market concept of the 1950's was transformed during the past decade into loosely constructed trade communities. Although it counts 10 members, the European economic market effectively covers the Continent. Free trade agreements negotiated between the EEC and nonmember European countries now constitute an operationally inclusive market.

In the Far East, an informal regional market functions with preferential tariffs accorded by Japan to its lesser developed Asian neighbors.

Manufacturers' groups have organized within this regional framework. Approximately 600 such organizations participate actively in foreign trade. They have taken the form of trade associations, export clubs, technical standards conferences, or government-industry syndicates.

Increased organization in the world marketplace is a function of industrial development and specialization. Manufacturers' groups promote industrial expansion. Regional markets strengthen local economies and encourage growth.

Nevertheless, the aggressive tenor of international commerce and the deterioration of the United States' trade position also point to the direct use of regional markets and manufacturers' combinations to limit American competitivity.

III. TOWARDS AN EFFECTIVE UNITED STATES TRADE POLICY

Foreign trade is essential to the United States' economic interest. In my opinion, an improved trade balance is a precondition to the success of the nation's economic programs. This improvement must be achieved principally through exports.

The world market system has moved to a stage midpoint between fragmented protectionism and GATT normalization: namely, it is dominated by foreign regional and industrial organizations.

Business is transacted in the realm of the feasible. Individual business will have extreme difficulty competing in this environment. Except for the few industrial supergiants, corporate entities are not equipped to deal with foreign governments or their instrumentalities. Industry combinations acting in concert are a breach of United States law.

In consequence, active government participation is needed to achieve free trade. United States trade policy should be mobilized to deregulate institutional and de facto obstruction to American competition in foreign markets.

Further, the practical reality of the international trade contest calls for an improved incentive system to encourage exports. Although export is ultimately profitable, it is expensive and risky upfront. The most effective incentives for healthy businesses seeking sales abroad would involve expanded measures to hedge against loss. These incentives should include insurance covering market development risks and tax measures providing deferral for overseas market development applied to taxation of domestic income.

In formulating a profitable trade policy, the United States need not exhaust its political and commercial resources to develop a compendium of trading laws. Rather, it should implement specific measures strategically targeted to help get export results.

I am a trade strategist. Our trading partners are fighting the good fight; they have a strong offense backed up by a solid defense. In private conversation they indicate that they have long expected the United States to rise to the trade challenge. They fully understand the just standard of reciprocity in trade matters. In furthering their interests, they have moved beyond the limits of reciprocity.

The alarming aspect in the United States' present trade position is the consistent passivity apparent in U.S. trade performance during the decline. This lassitude does not appear among our principal trading partners, who have been persistently active. Their aggressiveness and superior results reflect their knowledge of the value of trade tactics. They have acted accordingly. I urge the United States to do likewise.

OVERSIGHT OF U.S. TRADE POLICY

TUESDAY, JULY 28, 1981

U.S. Senate, Subcommittee on International Trade of the Committee on Finance and Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, and Urban Affairs,

Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Hon. John E. Danforth (chairman of the subcommittee) presiding.

Present: Senators Danforth, Symms, Grassley, Heinz, Byrd, Bradley, and Baucus.

[The committee press release for this hearing and the opening statement of Senator Heinz follow:]

Press Release No. 81-154

PRESS RELEASE

FOR IMMEDIATE RELEASE
July 20, 1981

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on
International Trade

FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE SETS HEARING ON EAST-WEST TRADE

Senator John C. Danforth, Chairman of the Subcommittee on International Trade of the Senate Committee on Finance announced today that the Subcommittee will hold a hearing on July 28, 1981 on East-West trade.

The hearing will begin at 10:00 a.m. on July 28, 1981 in Room 2227 of the Dirksen Senate Office Building. Chairman Danforth stated that this hearing is a continuation of the hearings held on July 8, 9 and 13, 1981 on U.S. Trade policy.

Secretary of State Alexander M. Haig, Jr., will be the only witness scheduled to testify at the hearing.

Written statements.--Witnesses who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record on the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Wednesday, August 5, 1981.

P.R. #81-154

OPENING STATEMENT BY SENATOR JOHN HEINZ

JULY 27, 1981

Mr. President, today's hearing is the last in a series of four reviewing U.S. trade policy in detail. Today's testimony from Secretary of State Haig will be particularly important because of the inevitable interaction--and sometimes tension--between foreign policy goals and trade policy objectives.

This tension was particularly noticeable during the past four years. The Carter Administration repeatedly attempted to use trade policy means, particularly export controls, to achieve political objectives. The grain embargo was the most celebrated case. Controls for human rights on other foreign policy reasons occurred as well. The effect of these efforts on their intended recipients is debatable. The effect on American exporters is clear. Whether the burdens we have expected exporters to bear are worth their cost is one of the most important issues we should discuss today. It goes to the heart of what you do, Mr. Secretary, and what your counterparts in the Commerce Department and the U.S. Trade Representative do.

Having seen ill-conceived economic controls fail to achieve their political objectives so often, I confess to considerable skepticism about them. Nevertheless, I agree that our broader foreign policy interests can justify them. What I hope to hear today is this Administration's policy with respect to embargoes and controls. Will they be used only for national security reasons? To combat terrorism? To achieve progress on human rights elsewhere? To respond to discriminatory actions by others?

Further, those of us here on the Banking Committee, which has jurisdiction over the Export Administration Act, will want to know how our national security is defined. Does it, for example, include European construction of the Yamal pipeline?

All of these questions are in areas where the State Department has considerable influence. In addition to learning your views on these matters, we will also want to discuss how you and your department fit into the decision-making structure on trade policy issues.

I would be remiss at this point if I did not also say a word about the past hearings. We learned that this Administration's trade policy is to be for free trade, against intervention, and for what I would characterize as a modest adjustment program based on the principle of survival of the fittest.

But the answer to a more important question still eludes us, and that is how this kind of trade policy can lead to any progress in international negotiations to break down trade barriers. Negotiation is a process of give and take, of mutual concession. By saying bluntly, as we have said, that our policy is not to intervene and not to protect, we leave ourselves very little to put on the bargaining table. How, for example, can we negotiate an end to performance requirements, if we have already firmly announced our intention not to employ them? How can we bring an end to other nations' export credit subsidies if we reduce the ExIm Banks' effectiveness? What leverage do we have in safeguard negotiations if our policy is to use them only on rare occasions?

I am not suggesting that we load our economy with protectionist devices so we can surrender them later on. I am suggesting that our policy as we heard it this month amounts to a statement that we do not intend to use the leverage we have, that we do not even intend to threaten to use the leverage we have, in negotiations. It seems to me that we may be planning on doing some table pounding, but everybody knows we don't intend to do anything to back it up. This is a kind of subtle divide and be conquered strategy. Our negotiators are going to say the right things, but their threats are going to be empty.

I hope that this impression is wrong, but I must say that the way we have been handling the export credit negotiations up until now is a classic example of my point.

I hope that Secretary Haig will also be able to comment on these perceptions and provide his own view of what the Administration's policy

Senator DANFORTH. The subcommittee will please come to order.

Mr. Secretary, I very much appreciate, as does the rest of the committee, your appearance before the International Trade Subcommittee. I am sure more members will be here when the vote on the floor is completed.

The relationship between foreign policy and trade policy is one that I think deserves the attention of the Congress and the attention of the country as a whole. The basic issue, which I would like to explore this morning, is to what extent, if any, international trade should be a tool of foreign policy.

For example, if a country which we deal with as an adversary or a competitor invade another country, should trade sanctions be imposed on that country in the future; should those trade sanctions apply to specific types of goods or commodities or be across-the-board sanctions.

How about friendly countries. If we are trying to build good relations with another country, should we aggressively enforce antidumping and countervailing duty laws against that country?

Some have said that at the time of President Lopez Portillo's trip to Washington, the United States gratuitously gave Mexico a concession with regard to subsidies in order to improve relations. Should we pull our punches, in other words, in order to enhance our position with friendly countries, or by contrast should we view trade strictly as a commercial arrangement between two or more countries, and what is good for trade drives our foreign policy rather than the other way around?

I think that is the general type of question that I am interested in, and I believe other members of the committee are interested in. Also, if this is something that deserves attention, and if there are going to be some criteria for the use of trade or trade sanctions, for the use of trade policy in the service of foreign policy, what kinds of criteria are they, and who should establish those criteria?

Should Congress have a hand in it, should there be some legislative guidelines for the imposition of trade sanctions or the use of trade as a tool of foreign policy?

Again, thank you for being here.

Senator Heinz, do you have an opening statement?

Senator **Heinz**. Very briefly, Mr. Chairman.

I think you have stated the central issues, the central issues are when do we use trade as a political weapon, whether it is for foreign policy, or for national security objectives.

In the last administration, there was a temptation to use trade, particularly export controls to achieve almost any objective, whether it was a human rights or national security objective.

There was a very mixed result, as we know, and it seems to me, Mr. Secretary, that you are the point man on all of the national security and the foreign policy decisions that will in the future be used as it relates to exports, and so I hope to hear today what your policy is, what the administration's policy is going to be with respect to embargoes and controls—whether they are going to be used simply for national security reasons, and whether you are going to use them, to crack down on those who harbor, aid, or abet terrorist movements. This is something I know you felt very strongly about when you first took over. The committee is also interested in knowing how do you intend to achieve your goals on human rights by other means, if you are not going to use the export controls we saw in the last administration. I also think there is a real question of how you are going to define national security.

It is not an easy job. For example, the issue of the European construction of the Yamal pipeline is defined by some members of this body as a national security issue, and there are some people who feel strongly that we should not be aiding in the construction of that pipeline project for natural gas from the Eastern bloc and the Soviet Union to our Western European NATO partners. So, Mr. Secretary, all of these are decisions where you and your Department have considerable influence, and we look forward to hearing, your testimony, and we very much appreciate your being here.

I speak both as a member of Senator Danforth's subcommittee and as chairman of the Subcommittee on International Finance of the Banking Committee.

Thank you.

Senator **Danforth**. Any other opening comments?

Senator Byrd.

Senator **Byrd**. Trade is very important to our economy and also important to our foreign policy, Mr. Secretary. The committee is very interested in what will be the administration's policy in this regard for the next 4 years.

We look forward to hearing from you.

Senator **Danforth**. Mr. Secretary, thank you for being here. Please proceed.

STATEMENT OF HON. ALEXANDER M. HAIG, JR., SECRETARY OF STATE

Secretary HAIG. Thank you, Mr. Chairman.

It is a great pleasure for me to appear before the subcommittee, and I have prepared a rather lengthy formal statement for consideration by the members of the subcommittee, and I would also like to bore you, if I may, with an opening statement, which is a capsulation of that more lengthy articulation of our trade policy, so if I may, I will launch this hearing today with that reading.

Mr. Chairman, today international economic developments are of critical concern to U.S. foreign policy, and thus of course to the State Department.

I am therefore particularly grateful for the chance to testify before this committee on international economic policy.

Our policy begins by recognizing that a strong American economy is the cornerstone of our national security. Our strength depends first and foremost on the success of the President's economic recovery program.

It is indeed one of the main pillars of U.S. foreign policy today, and the success of that program will be facilitated by a prosperous and well functioning world trading system.

Trade is an increasingly powerful source of innovation and growth for the American economy. We gain from access to the world's markets and the spur of international competition. Our producers and consumers benefit from access to foreign goods and raw materials. Thus trade clearly reinforces the President's domestic efforts to reduce inflation, to increase production, and to expand employment.

Finally, healthy trade relations can strengthen friendships and alliances and help integrate countries into the market-oriented trading system which has served us so well.

After World War II the United States and its partners set out to create a new trading system based on fair rules and a commitment to reduce trade barriers, hoping to avoid the protectionist policy that played havoc with the international economy during the 1930's.

This system known as the General Agreement on Tariffs and Trade, GATT, has served the American interests well. In 30 years U.S. exports multiplied by twentyfold and created millions of jobs for American farmers, workers, shippers, truckers, longshoremen, insurers, and bankers.

The dramatic growth in trade since the war has strengthened our own economy and that of our partners as well.

Today the international trading system is under heavy strain. Many countries face enormous pressures to protect industries.

Trade is distorted by restrictions on imports, support for noncompetitive exports, misuse of investment policy as a trade instrument, and failure to open markets adequately while taking advantage of the open markets of others.

Unless handled satisfactorily, these problems and distortions could severely weaken the international trading system, disrupt the world economy, and threaten international cooperation at large.

The Ottawa summit provided a fresh impetus to advance an open international trading system. But this momentum must be sustained by firm leadership, not just by one or two nations but by the industrial and developing nations working together.

The United States will play its part. President Reagan has committed this administration to the support of an open trading system on the basis of agreed rules. At the same time, we have asked for similar undertakings from other countries. We were therefore pleased that we and our partners at Ottawa agreed to:

> Reaffirm our strong commitments to maintaining liberal trade policies and to the effective operation of an open multilateral trading system, and that we will work together to strengthen the system in the interests of all trading countries.

This reaffirmation is particularly noteworthy in view of the several new heads of state at Ottawa and the range of political and economic persuasion they represent, not to mention the exceptionally trying economic straits in which some find themselves today.

This administration wants to help our citizens to take advantage of trade opportunities abroad. As the President's program brings down inflation and stimulates productivity, it will permit our firms to improve their competitiveness.

Bill Brock has told this committee of our administration's attempts to reduce export disincentives and improve U.S. promotion programs.

I fully support his work and that of Secretaries Baldrige and Block to increase exports. I have asked our ambassadors to play an enthusiastic and leading role in supporting our export effort. I have recently written them a definitive letter instructing them to do so.

Over the next decade, access of developing countries' exports to developed country markets is crucial to their growth and thus fundamental to the economic and political stability of the developing world. For many of these countries, exports and private investment are far more important than aid flows.

And developing country markets are increasingly important to the United States. The developing countries now buy more U.S. goods than Japan and the European Community combined. Export opportunities in the developing world will boost our own exports and our domestic economy.

We intend to maintain open markets for developing country products and we expect the advanced developing nations to open their markets to our goods.

We have devoted considerable attention recently to the Caribbean basin. Careful discussions have begun with Canada, Mexico, and Venezuela, as well as the Caribbean countries themselves about the best approach to promote economic progress.

We welcome advice and suggestions from the Congress on this issue.

In the area of East-West trade the links between trade policy and foreign policy are very clear. Our trade and economic relations must reinforce our efforts to counter the Soviet Union's military buildup and its irresponsible conduct in a number of the areas of the world.

We must take into account our commercial interests, but security concerns remain paramount.

We must strengthen cooperation among our friends and allies. An effective East-West economic policy cannot be carried out by one country alone.

Over the last several months we have carefully reviewed our policy on East-West relations. We did so because we wanted to be as precise and as clear as possible at the Ottawa summit about our concerns and about our proposals for addressing them. We did so not because we wished to impose any particular solutions on the countries represented there, but because we wanted to initiate a serious discussion of East-West trade relations at the very highest level.

That discussion was launched, and we were encouraged by the attitude that, indeed, in the field of East-West relations, the West must insure that its economic policies are compatible with its political and security objectives.

Since 1949 the United States and its allies have maintained strategic trade controls with the objective of restricting the flow of advanced hardware and technology to preserve our technological edge and prevent advances in Soviet military capability.

On the basis of our review, we concluded that a tightening of restrictions on goods and technology in areas relevant to Soviet military strength was both desirable and necessary.

The President presented our approach to the other leaders at Ottawa, stressing the importance he attaches to working with them to achieve tighter restrictions.

We will discuss our proposals in greater detail in coming weeks and months and at a high level COCOM meeting this fall.

We also believe that any tightening of export controls must be accompanied by increased efforts to police those controls.

We and our allies have begun discussions with other COCOM countries to improve cooperetive enforcement efforts.

A second key area for improved cooperation is that of contingency planning, so that the democracies can react clearly to Soviet adventurism and the use of force.

The economic measures taken after the Soviet invasion of Afghanistan indicate that controls are more effective when implemented collectively and when the burden is not borne disproportionately by specific sectors and only a small group of countries. Coordination should take place in advance of a crisis.

Over the last several years there has been an awakening to the dangers we face in common and a stronger dedication to deal with these dangers in a more innovative and effective way.

Our objective is not to impose our views but to reach agreement with our allies on a common approach.

I am convinced that our trade policy, which you and your colleagues are so instrumental in shaping, has a major bearing on the health of our economy and on our country's place in the world.

An active and effective U.S. trade policy can strengthen our domestic economy and our political ties with developed and developing countries. An effective trade policy toward the Eastern countries can permit commercial exchange with them in certain sectors while insuring that we and our allies can limit such exchanges when our common security interests require it.

My Department and U.S. Ambassadors worldwide stand ready to play an active role in supporting U.S. trade policy. We shall work closely with Bill Brock and Secretaries Baldridge and Block and with this committee on these issues.

Thank you very much, Mr. Chairman. I welcome your questions.

Senator DANFORTH. Mr. Secretary, thank you very much.

In this committee we follow the early-bird rule. I am the early bird. Other Senators in their order of arrival were Senators Symms and Heinz, Senator Byrd, Senator Bradley, and Senator Baucus.

It is my understanding of your testimony, Mr. Secretary, that in the event of aggressive action by the Soviet Union, the United States would in fact use trade as a weapon, that we would impose trade sanctions against the Soviet Union; is that an accurate reflection of your testimony?

Secretary HAIG. I do not like to use the phrase "trade as a weapon." I would prefer to describe trade as an essential aspect of an integrated political, economic, and security-related approach to the conduct of our relationships with the Soviet Union. In that context, the trade aspect would be given careful consideration when Soviet activity abroad dictated use of a broad range of assets to hopefully encourage moderation or modification of ongoing policy.

Senator DANFORTH. In any event, the Soviet Union should expect that trade sanctions would likely follow aggressive activity on their part; is that correct?

Secretary HAIG. Well, I think it would be self-defeating to discount that possibility a priori, and to suggest that trade would be exclusively unaffected among all our relations with the Soviets.

Here again, I want to emphasize that we cannot hope to optimize our effectiveness if we approach this unilaterally with a narrowly focused prism; we have to look toward a collective approach, which is both flexible and integrated.

Senator DANFORTH. I think that I heard you saying yes, and that you would like to work things out with our allies so that they would join us in any such effort.

Secretary HAIG. That is what I said while avoiding those happy cliches, those one liners which sometimes do not capture the essence of our policy. [Laughter.]

Senator DANFORTH. It was not quite a one liner.

Also it was my understanding of your testimony that specific sectors of the American economy, such as, for example, the agricultural sector, would not be singled out for special duty in the event the trade sanctions were imposed?

Secretary HAIG. Yes. As you know, Mr. Chairman, the President, and I share his concerns, feels very strongly that placing such a burden on the agricultural sector alone is both ineffective and self-defeating as an approach to trade restrictions when they are called for.

Senator DANFORTH. Mr. Secretary, some have felt in the past that the State Department's position on trade matters is that trade is viewed as secondary to other policy consideration of the administration, and particularly in dealing with friendly countries, that the position of the administration is in essence don't drive a hard bargain, don't enforce our rights, pull our punches in the enforcement of antidumping and countervailing duty laws, don't make our friends mad at us by insisting on the full measure of our rights, the full enforcement of the law.

Some have felt that was our position, for example, with respect to Mexico, at the time of President Lopez Portillo's visit.

What is the position of the administration on enforcement of trade laws with respect to friendly countries?

Secretary **Haig**. Well, I think as a general matter, that the State Department would monitor how well we are getting along with our friends and how effectively we are dealing with our potential enemies. We are the repository of the Government's expertise in this area, so in general, I would expect that the focus would be on the Department of State. But I think it is also important to recognize that the matters addressed in your question are best and most effectively dealt with by an international code of conduct, if you will, that is both specific and understandable and which creates the circumstances for open and free trade, as the best objective we can seek.

Now, from time to time, and perhaps even increasingly so in the recent past, as economic difficulties developed worldwide, our trading partners may adopt protective devices of one kind or another, which impose unfair burdens on certain sectors of the American economy.

We believe as a general rule, again in a very flexible way, that existing antidumping and other laws on the books do provide appropriate recourse, and I hope that the main focus of all that we do in international trade would be to reduce and eliminate the policies that create the problems you speak of. That is what we addressed at Ottawa and I think very successfully.

Senator **Danforth**. Yes. Well, dumping and subsidies are provided for, because recourse against them are provided for in the law, and they are dealt with in international agreements among countries. But it is up to each country to do its best to enforce its rights and enforce the laws, and I take it your position that if a country, no matter how friendly, is violating the law and is engaging in practices which violate the codes of conduct of international trade, that we should have no qualms at all about enforcing our rights and about enforcing the law.

Secretary **Haig**. There is no question but that we would support prompt and dull enforcement of our existing laws and regulations in that regard.

Senator **Danforth**. Do you believe, Mr. Secretary, that trade is an effective tool which should be used to leverage decisions of other countries with respect to human rights, immigration policies, nonproliferation of nuclear capability? Do you think the United States should be using trade as a means of achieving those goals?

Secretary **Haig**. Well, Mr. Chairman, of course trade is one of many tools that can be applied to moderating offensive policies in the areas that you described.

I think it must always be used with the greatest of caution, to be sure that the application of that particular lever is able to and will in effect achieve the objective we seek.

If the consequences were to be isolation and harder intransigence, and we have had that in some instances, I think it would be imprudent application of a very valuable asset. These are judgments that must be made with great care and caution in consideration of all of the other alternatives, and in consideration of the degree of success we would anticipate with the application of this pressure.

Senator DANFORTH. Senator Symms?

Senator SYMMS. Thank you very much, Mr. Chairman, and welcome to the subcommittee, Mr. Secretary.

I have several questions I would like to ask you, and I do not know quite where to start, but I would like to first ask one about problems of a corporation, which has been having a problem, it deals with the broader concept, but it is the specific one I happen to be aware of, they make a product which is a herbicide, and it appears that the Hungarians are stealing the patent, and they are marketing the product to the Third World countries, and there is a meeting coming up on July 30, where our special trade representatives and the Hungarians will get together.

Could you give me the insight on how our approach will be to that, and is that a violation of our trading laws to have them stealing patents and marketing those products in Third World countries?

Secretary HAIG. You are correct, Senator Symms, that this is a very active and dynamic exchange that we are having right now with the Hungarian Government. We of course seek a satisfactory solution with some urgency, and I hope that the forthcoming meetings will result in a satisfactory solution.

Senator SYMMS. Well, I certainly hope so, and I would like to offer my encouragement to help get that resolved, because it seems to me it certainly puts the American businessman at a disadvantage to have to deal with this kind of atmosphere.

On the subject of the Yamal pipeline, has the administration decided where we stand on that, and whether or not Caterpillar Tractor Co. will be allowed to participate?

Secretary HAIG. Well, I think, I cannot answer that question with a simple one liner again because of its complexity.

It is a subject that we studied and debated internally in the executive branch at some length before the recently completed Ottawa summit, and we recognize in the first instance, that the project itself is a decision to be made by our European partners. They are going to fund it. It is for their needs, and they have a degree of independence as they approach the situation. Second, we have discussed the pipeline with the Europeans for a considerable period of time. In the case of West Germany, for example, Chancellor Schmidt, clearly before the Ottawa summit, and in discussions I have had with him and his Foreign Minister on this topic over the last 6 months, has indicated that he is going to address it on a purely commercial basis.

I would want to emphasize that our European partners are very concerned about their almost exclusive dependence on OPEC energy sources, and they believe it is imperative to diversify their sources of energy.

I want to emphasize that maximum development of this pipeline would supply, with respect to West Germany, about 30 percent of their natural gas requirements and somewhere in the neighborhood of 5 percent of their overall energy requirements.

We have continually expressed our concern about excess dependency in Western Europe on Eastern source energy.

At the Ottawa summit, this concern was again expressed. It was expressed primarily in the context of the U.S. willingness immediately to offer our European partners alternative solutions to this pipeline, at least to the pipeline as currently visualized. I think ultimately funding requirements, changes in the energy market itself, and changing access opportunities may end up reducing the size of this pipeline substantially from that originally visualized. But we have offered, and we are following up with our European partners some alternatives which we hope would he comparable in terms of availability, costs and above all reliability. I am talking about access to U.S. coal and nuclear power resources, and other non-OPEC or non-Eastern oil and natural gas resources. This is clearly our obligation—to put forward an attractive package.

Senator SYMMS. So I take it frcm what you are saying by that statement that you do not buy the statement which you often see scattered about that the world leaders, where they use the term reliable, where such as the Germans talk about how reliable the source of energy might be from the Soviet Union, you do not buy that, do you?

Secretary HAIG. No, I think recent——

Senator SYMMS. Of course, more reliable than say the Middle East, or more reliable than American coal?

Secretary HAIG. Well, I certainly would not categorize it as more reliable than American coal, but there are other disadvantages to American coal.

For example, in West Germany—we discussed this with Chancellor Schmidt—I do think that recent history suggests that the possibility of unreliability of Eastern sources is something that cannot and must not he overlooked. But we have also had some recent experiences, in 1973, on the unreliability of OPEC sources.

Now, that situation has improved, happily, but it cannot be discounted either, and that is one of the great driving forces in our overall energy approach here in the United States, in Western Europe, and certainly in Japan.

Senator SYMMS. Well, it would certainly appear to me it would he very difficult for our friends in Western Europe to rely on Russian gas at a time of heightened tensions between the United States and the Soviet Union.

I would think it would be a natural place for them to try to pull the plug.

I have a few more questions, Mr. Chairman. I cannot quite see that clock.

Senator DANFORTH. It is still green.

Senator SYMMS. All right. It is still green.

Senator Garn is very interested in this, and the Secretary has addressed several points that Senator Garn is interested in.

One of the questions that he would like to have asked, it goes like this.

The West Germans argue that they are diversifying their sources and not becoming dependent on the Soviets, although 30 percent of their gas will be provided by the U.S.S.R.

At the same time we are pulling back, or so we say, from the Nixon-Kissinger doctrine which was to increase high technology trade and make the Soviets dependent on the West. What we end up with is a policy where the West is dependent on them not only for gas, but for repayment of their huge debts, while they are weaned from dependence on us.

Do you think that is a fair statement?

Secretary HAIG. Well, there are a lot of statements in that question, Senator.

Some of them I would be comfortable with and some I would not.

I do not know, for example, of any American policies which were designed to make the Soviet Union dependent on the West.

I know there are some specious theories on the airways that would suggest that is a good thing to do, but having been associated with the Nixon-Kissinger policies, I do not recall that that was characteristic of their policy.

Having said that, I make no bones about our concern with the implications of increased reliance on Eastern sources for energy in such a vital and critical and strategic area, and we have expressed that concern.

Senator SYMMS. Well, let me ask you a very fundamental question. It may be one which you may not want to answer.

But should the United States seek to promote or retard the growth of energy in the Soviet Union?

Secretary HAIG. Now, I think this is an extremely complex question, and it has a number of interrelated overtones.

In general, I would reject the thesis that if we do not help the Soviet Union develop its own energy self-reliance, it is going to be faced with an incentive to move into the Middle East and seize external resources.

On the other hand, I do not reject that such an approach could have that consequence, but I think if we conducted our own policies with a preoccupation over that consequence, we would be on a self-defeating course.

Senator SYMMS. Thank you very much.

Thank you, Mr. Chairman.

I would like to say in closing, Mr. Secretary, I just want to encourage you to try to, so to speak, inundate the Iron Curtain countries with Sears Roebuck catalogs, which shows private ownership, because I think that is the best way to beat them.

Secretary HAIG. I do not disagree.

Senator DANFORTH. Senator Heinz?

Senator HEINZ. Mr. Secretary, I want to address briefly the issue of trade, and the Yamal pipeline which Senator Symms mentioned.

If there were no other source of technology available from the West, other than the United States, would you support the United States building the Yamal pipeline or not?

Secretary HAIG. If there was no other source?

Senator HEINZ. If we were the only country that could supply the technology, or alternatively, if we could get the agreement of our European allies, that this was a strategic call, and the call would be up to COCOM, which we have a role in, would you advocate building or not building the Yamal pipeline?

Secretary HAIG. Well, I do not see anything in the circumstances in your question that would change the basic position that I have suggested, and that is that I would far prefer that we look for and devise, which is within our capability, other alternatives than that.

Senator HEINZ. Well, I suppose so, but suppose that we have a meeting of COCOM, and everybody says, Mr. Secretary, we think this is of great strategic importance, the decision is whether or not to go ahead, and we are looking to you for advice.

It is go or no go, and, Mr. Secretary, the decision is up to you, what do you say?

Secretary HAIG. I think my advice has been against that, and would remain so.

Senator HEINZ. And you would say no, and you would urge our COCOM allies not to go ahead?

Secretary HAIG. Absolutely.

On the other hand, I want to be sure that the hypothetical aspects of your question do not suggest that we are in that position today.

Senator HEINZ. Well, do you intend to make COCOM more effective and more fully functional, so that you can get into that position?

Secretary HAIG. Well, I think that is also another important aspect of COCOM today. We would not anticipate that COCOM itself would address such an issue, because it focuses exclusively on defense-related end items and technology.

As a matter of fact, this has been another aspect of a review that we have just completed, that is to try to broaden it into the technology area, into areas that are related to defense, but not necessarily directly attributable to defense.

Senator HEINZ. So you would like to see COCOM be more active in areas such as this?

Secretary HAIG. We would like to see a substantial strengthening in COCOM regulations, and in the consensus that is necessary to make it a more effective control.

Senator HEINZ. I salute your objective. I wish you good luck. You are going to need a tremendous amount of it to strengthen COCOM. It has not been one of the great successes, even though in theory it is an excellent organization.

Do you have any ideas on how you are going to achieve that very ambitious objective?

Secretary HAIG. Well, I am optimistic. I do not have to tell you that there was considerable concern among some of our partners at Ottawa, that they may be witnessing a sudden knee-jerk new American direction, which will not be consistently maintained in the political spectrum of American life. They have been confronted with that in the past, and I think it is very important that we disabuse them of that concern and approach this thing in a systematic and consistent way.

Senator HEINZ. Mr. Secretary, one of the very real national security strategic threats that is faced by the world is the potential for a Soviet invasion of Poland.

Is it true that we and our allies, either at or before the Ottawa summit, have agreed on a common policy that we would implement in the event of such an invasion or not?

Secretary Haig. Senator Heinz, we had, I think, a very unsatisfactory experience with the Afghanistan case, whether you are for or against Olympic boycotts.

We certainly did not have a consistent Western approach, within the NATO family, and in other forums. I think the lessons were learned, and as a result we have been in intensive continuous consultations, especially in NATO, to put together a range of contingency responses in the trade and in other political diplomatic areas, if we are faced with the outcome you described.

Now, while these are not precommittal in the same sense that chapter V of the NATO treaty is not precommittal, the coordinated structure has been completed; it is very effective, it is very detailed and very encouraging.

Senator Heinz. Do you anticipate, given the structure that you mentioned, that trade, credit, or export and import embargoes, one or the other, would be a part of such a strategy to confront the Soviet Union should they be so unwise?

Secretary Haig. Without presuming to comment on the sensitive difficulties this could bring to some of our allies and perhaps to ourselves, I would say that the range of actions under consideration is broad and sweeping in character and includes political, economic, and trade steps, including the kinds of things you discussed as possible reactions.

Senator Heinz. Mr. Secretary, Senator Danforth mentioned that in the past there has been a temptation in previous statements to treat trade as secondary, and almost as a goody to throw into the diplomatic pouch when trying to get a favorable answer.

Could we look for a turnabout, could we depend on the State Department, instead of treating trade as something to trade away, to aggressively put its prestige and authority on the line, and in effect maybe spend a few of your chips promoting trade by breaking down some of the tremendous protectionist trade barriers thrown up around the world?

Secretary Haig. Well, I think I can assure you, Senator, that this State Department is dedicated to the proposition that we must do all possible to remove artificial barriers against free exchange in the trading area.

Again some times how best to accomplish that is a difficult and contentious question, whether you do it best with a stick or a carrot.

These are judgments which will come up repeatedly and will always offer the grist for differing viewpoints.

Senator Heinz. Well, what I hear you saying is that you would like to say yes to that, but you are not sure you can say yes in every instance.

Secretary Haig. No, I think I can reassure you beyond question with respect to the objectives and the policies we will pursue.

Senator Heinz. Well, as you know, with respect to North-South trade, there are increasing local content requirements, a variety of trade barriers going up in the developing countries.

Should we condition our participation in the multilateral development banks on the degree to which other people will participate with us on a lowering of those kinds of trade barriers?

Secretary HAIG. Well, again, the simple answer would be an incorrect one.

I think it is a consideration that must weigh very heavily on our overall approach to the multilateral banks.

Senator HEINZ. Are you willing to use that kind of leverage? To my knowledge we have not used that kind of leverage in the past to achieve a more open trading system.

Secretary HAIG. Again, to answer your question, I would frankly prefer hard-nosed administrators throughout the various policy boxes of the multilateral banks for example, the World Bank, not only the demeanor or the President of the World Bank with respect to this, but the Director; we should try to correct the problem in a uniform way, and not to look always and exclusively toward what I call reactive policies, but I do not reject reactive policies either.

Senator HEINZ. Mr. Secretary, my time is up.

I would agree with you that it should be pursued in a uniform multilateral way. That is why I singled out multilateral institutions. Some of us feel that there is a good deal of strengthening of the GATT in terms of further codification that needs to be done.

Thank you for your testimony.

Senator DANFORTH. Senator Byrd?

Senator BYRD. Mr. Secretary, the Ottawa summit communique states that the seven governments will undertake to consult to improve the present system of controls on trade in strategic and related technology with Russia.

What next steps in this process do you anticipate?

Secretary HAIG. Well, I anticipate there will he a high-level COCOM meeting in the fall designed to address specifically those items.

I think that is paragraph 37 in the communique.

Senator BYRD. Mr. Secretary, how important is resource rich, mineral rich South Africa to the United States and to the free world?

Secretary HAIG. Well, I think both South Africa and Southern Africa at large are extremely important to the free world, strategically, demographically, in military and political and economic terms as well.

Senator BYRD. Mr. Secretary, efforts are being made by some groups within the United States and within the United Nations to curb trade with South Africa.

What is the administration's position?

Secretary HAIG. Well, I do not like to get out ahead of situations before they develop, but in general we are opposed to trade sanctions against South Africa.

Senator BYRD. Mr. Secretary, do you favor the People's Republic of China joining the GATT, and if so, what terms and conditions would you attach to the joining?

Secretary HAIG. Frankly, Senator, I have not addressed this question in terms of whether we would be opposed or against, but I think if the People's Republic of China is prepared to accept the conditions of GATT membership and abide by the responsibilities that they entail, that in general it is in the West's interest, and the free world's interest, and the developing world's interest, to have China become increasingly an active participant in the international family of nations, in trade and in other areas as well.

Senator BYRD. Looking ahead to the 4 years of the present administration, how do you see the potential of China as a trading partner?

Secretary HAIG. There is no question that a quarter of the world's population, a billion people, represent an unusual long-term trading partnership opportunity for the United States and for other like-minded nations.

I would raise a cautionary flag that from time to time, the appetites of Western nations for this trade have exceeded the ability of either the West or the People's Republic of China to carry it in financial and developmental terms. In fact, one of the problems I found in my recent trip to the People's Republic of China was a sort of reactive disappointment that some of the early exuberant anticipation, both in China and with their potential partners, was not realized, because of the fiscal realities of the world in which they live.

Senator BYRD. China has the people, of course, but does it have the banking facilities or the funds to become a real large-scale trading partner with the United States within the next 3 or 4 years?

Secretary HAIG. They have already become an important trading partner with the United States, but this has got to be done in an evolutionary way in which expectations do not exceed capability, and that means a very systematic and two-way communication between our two Governments, to optimize current limited potential.

Senator BYRD. Mr. Secretary, do you favor or oppose relaxing the trade barriers between the United States and Cuba?

Secretary HAIG. Well, I have seen nothing in recent Cuban activities in this hemisphere, in Africa, and elsewhere, which would suggest in any way any loosening of the current restrictions, and perhaps we should be looking at further tightening.

Senator BYRD. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Senator DANFORTH. Senator Bradley?

Senator Bradley. Thank you very much, Mr. Chairman.

Mr. Secretary, I was curious to read in the newspapers two different stories of what happened in Ottawa.

Was there an agreement among the allies on the Yamal pipeline?

Secretary HAIG. The answer to your question is no, and there was none sought, and there was none even anticipated, for many reasons, the first one being that all of the seven who participated in the summit were not involved in the pipeline question.

Second, because it would be highly presumptuous of the United States, which cannot control, is not financing, is not assisting this project, to expect to set an agreement with respect to it.

What we hoped to do, and what we did do, was to express our genuine concern about increased French and German reliance on such a pipeline, and to ask our partners to consider with us jointly other alternatives, and to present these alternatives to them in very timely fashion.

Senator BRADLEY. So the United States did not tell the Germans to refrain from seeking financing for the project?

Secretary HAIG. No, not in the context of your question.

We did urge them to consider other alternatives before proceeding with the financing.

Senator BRADLEY. Did the United States say anything that would lead the West Germans to believe that we would strongly oppose them proceeding with the financing of the Yamal pipeline by trying to put together the loans from the consortium banks?

Secretary HAIG. No, not in the way you describe it.

As a matter of fact, in my view that would have been a self-defeating, if not a highly damaging, approach for the United States to take, something similar to the approach in the last administration with respect to peaceful uses of nuclear energy.

[The following letter was subsequently supplied for the record:]

DEPARTMENT OF STATE
Washington, D.C. 20520

3 SEP 1981

Dear Senator Bradley,

I am writing in reply to your questions regarding the Siberian Pipeline, European energy security, and international gas trade submitted to the Department on August 7. I regret the delay in responding to you.

Your questions touch on many of the key points that lead us to be concerned about the proposed Siberian Pipeline. As you know, President Reagan discussed our concerns with his European counterparts at the recent Ottawa Summit. Based on those discussions, the leaders agreed to work together to consider Europe's projected needs for additional gas imports and alternative sources of gas and other energy supplies.

The Administration is now carefully reviewing the state of play on the prospective pipeline and the more general issue of West European energy security in light of the President's discussions at Ottawa. We now are considering many of the issues you raised and expect to gather additional information and to discuss the issues further in the course of consultations with our Allies. The following answers to your questions are based on the information presently available.

Our European friends and allies could become more dependent on Soviet gas while remaining highly dependent on Near Eastern oil. As you know, West European-Soviet negotiations on the proposed Yamal pipeline are at an advanced stage. If the project proceeds as originally conceived, the pipeline could deliver 40 billion cubic meters of gas to Western Europe annually. In that case, West Germany, for example, could depend on Soviet gas for as much as 30 percent of its total gas consumption, approximately 5 percent of total West German energy use.

The extent to which our European friends and allies could become significantly dependent on both Soviet gas and Middle Eastern oil is most uncertain. That will depend on

The Honorable
Bill Bradley,
United States Senate.

general energy and economic developments, possible changes in European energy plans, and, to some extent, on upcoming U.S.-European consultations.

Increased supplies of Soviet gas could help advance Western Europe's continued efforts to reduce their dependence on Middle Eastern oil. West German officials, for example, have stated publicly that they view Soviet gas as an alternative to Middle Eastern oil. Yet, the Europeans may still have to depend on Soviet gas to offset declining continental European gas production and decreases in Soviet oil exports to Western Europe.

In the case of Japan, there are no real prospects for joint dependence on Middle Eastern oil and Soviet gas in the near term. The Japanese and Soviets are exploring oil and gas reserves on and around Sakhalin Island. There has been some discussion about the possibility of delivering Sakhalin LNG to Japan. But in light of the limits to current knowledge about the Sakhalin reserves, and about the feasibility of Soviet LNG processing and transport, Soviet LNG exports to Japan are, in all likelihood, a long way off.

In the context of considering and laying groundwork for the Siberian gas pipeline, European governments and industries have begun to plan and to arrange emergency preparedness measures which would limit their vulnerability to Soviet supply interruptions. Analytically, these preparedness measures should be considered in two separate categories --measures to deal with technical supply interruptions; and measures to deal with politically motivated supply interruptions.

It is likely that technical problems would interrupt Soviet deliveries of gas to Western Europe at various times during the life of the pipeline. The proposed project is massive and would span a hostile terrain. One must therefore anticipate the possibility of technical breakdowns and failures. Responsibility for dealing with technical interruptions will fall in large part, to the West European utilities and companies participating in the pipeline project. This technical risk is not wholly unlike that associated with any major gas development and transport project.

The more difficult problem to anticipate, and to plan for is politically motivated supply interruptions. This is an issue in which governments have a more important role to play, and which has been a subject for continuing U.S.-European consultation. European efforts to establish contingency plans and provisions in this area are by no means complete.

We expect to discuss this issue with the Europeans in detail at forthcoming consultations on the pipeline. In the past we have pointed to specific measures which could be included as part of European plans and a safety net, including stored gas reserves, dual-fire capabilities, emergency surge and delivery capability, greater oil stockpiles, restrictions on the use of incremental gas supplies to the industrial/commercial sectors, emergency demand restraint measures, greater integration of European gas grids, and a gas sharing agreement which would tie into the EC oil sharing systems in the event of a concurrent shortage of oil and gas.

We do not anticipate that European-Soviet energy relations would substantially alter the significant U.S.-European security interests in the Middle East. We therefore do not see a need at this time to develop contingency plans for mobilizing allied support for joint opposition to possible Soviet intervention in the Near East. One central objective of our policy toward the pipeline is to insulate common Western security interests, and to make certain that our European friends and allies do not become vulnerable to Soviet energy leverage.

If the Europeans do proceed with the proposed pipeline, they must make contingency plans for dealing with a possible joint cut off of Soviet gas and Middle Eastern oil. In such an event, the European countries affected most seriously might seek greater contributions to the emergency sharing systems from those countries not affected by the Soviet cut off. In preparing for such an event, the Europeans may wish to develop an emergency gas sharing agreement and to increase their strategic petroleum holdings. These and other contingency measures will have to be discussed in the context of consultations on the pipeline with European leaders.

Prospective European participants in the pipeline project have been bargaining with the Soviets in separate bilateral negotiations. Nonetheless, there is collaboration among the European negotiators, and they appear to have been generally successful in presenting a collective position on the terms and conditions of pipeline finance, construction and operation. It is not clear that any specific U.S. measure could improve the coordination of these talks.

U.S. efforts to increase the availability and/or commercial competitiveness of non-Soviet gas and other energy sources might improve Europe's bargaining position with the Soviets. As you know, we are currently considering measures the United States could take to improve Europe's bargaining position and either to eliminate, or significantly diminish, European perceived requirements for Soviet gas.

U.S. participation in world natural gas trade outside of North America has been minor compared to that of our European Allies. As you know, the vast bulk of U.S. natural gas imports orginate in Canada or Mexico and only to a very small extent from LNG sources.

The abundance of natural gas reserves in North America coupled with the significant processing and transportation costs of LNG, have limited the role that LNG has played in the U.S. natural gas supply picture. At present, the United States receives modest quantities of LNG from Algeria under a single contract, and anticipates delivery under a second contract to begin shortly. Moreover, U.S. companies' discussions with prospective LNG exporters, principally Nigeria and Indonesia, are still in a preliminary stage.

Recent U.S. regulatory policy has required that natural gas imports under new contracts be priced to be competitive with alternative fuels in end use markets. This policy helps assure that natural gas imports are not implicitly subsidized by rolling in higher priced imports with price controlled U.S. natural gas. Disagreement over price was a major factor in the suspension of negotiations for natural gas imports from Nigeria by El Paso.

The future role for the United States in world LNG trade is unclear. There is little doubt, however, that increased reliance upon market forces--whether through the present statutorily established decontrol schedule or some other approach--to determine the appropriate price for natural gas in the U.S. market will oblige U.S. gas purchasers --and thus LNG producers--to heed price signals very carefully. Whether natural gas prices in the United States rise substantially as a result of decontrol is unclear, but decontrol is certain to have important influence on the U.S. supply and demand picture in the years to come. How LNG fits into the U.S. energy picture may well depend upon the willingness of LNG producers to price their product competitively with U.S. origin fuels in end-use markets. With these factors in mind, it is unlikely that U.S. competition for future LNG supplies would be a significant constraint in our allies' plans to expand LNG use.

I trust that this information answers the questions you submitted to the Secretary.

Sincerely,

Richard Fairbanks

Richard Fairbanks
Assistant Secretary
for Congressional Relations

Senator **Bradley**. Let me turn now, if I can, in your prepared statement you mentioned something ahout restrictions on trade with the Soviet Union and the East bloc in the event that the Soviets moved into Poland.

You said there were a range of actions being considered.

Do you believe that we could take as an allied bloc successful trade restrictions without damaging our own economies?

Secretary **Haig**. No, I think there would be inevitable damage to Western economies by such a policy.

Senator **Bradley**. What would be that damage?

Secretary **Haig**. Well, the damage would be very typical of sudden trade restrictions.

It could occur in credit areas.

Senator **Bradley**. You mean Western banks would be vulnerable?

Secretary **Haig**. Banks could be vulnerable. Financial institutions and governments could be vulnerable.

Clearly the private sectors, or the public sectors, would be affected in their production and trade levels.

But I think you must also bear in mind that our vulnerabilities there do not surpass the damage that would come from our failure to react to another blatant act of Soviet aggression; these are prices that are well within our capability to pay, and I think most of the Western nations recognize this and would be willing to pay the price.

Senator **Bradley**. Do you think the Germans are willing to cooperate in very strict trade restrictions?

Secretary **Haig**. I think under a specific set of provocations of the kind that you described, the direct intervention of Soviet forces into Poland, it would be inevitable, and indeed I would suggest that perhaps politically impossible for any incumbent government in Western Europe to ignore such a consequence.

Senator **Bradley**. What percent of the West Germany employment is tied up in some way with East-West trade?

I guess it is close to 25 percent.

Secretary **Haig**. I think Chancellor Schmidt used something substantially below that, Senator, somewhere in the neighborhood of 3 to 4 percent.

Senator **Bradley**. Three to four percent of all employment?

Secretary **Haig**. Of their overall trade.

Senator **Bradley**. But how many jobs are connected to that trade. Put another way if West Germany suspended trade with the East in a retaliatory action, how would it affect the unemployment rate in Western Germany?

Secretary **Haig**. Well, I would prefer not to shoot that one from the hip, I did not come here with the information in my pocket. I will have to provide that answer for you.

[The following was subsequently supplied by Secretary Haig:]

Answer. Exports to the Warsaw Pact countries, taken together, account for about 6.3 percent of total West German exports and about 1.1 percent of GNP. This includes exports of $4.4 billion to the Soviet Union in 1980, which amounts to 2.3 percent of total exports and 0.5 percent of GNP.

Our best estimates are that about 300,000 workers are directly employed in producing goods for export to Eastern Europe and the Soviet Union. These jobs represent about 1.2 percent of West German employment, but they do not completely convey the full impact of an embargo of that trade. It is difficult to determine the percentage of employment which is indirectly dependent upon such exports, such as supplies of intermediate goods, transportation services, etc.

Some sectors of the West German economy would be affected by an embargo more severely than others. Exports of steel and metalworking machinery to the USSR alone constitute roughly 10 percent of total FRG exports and 5 percent of total sales of such products.

Summary of Trade Between Summit Countries and the Soviet Bloc (U.S. $ millions)

	U.S.		Canada		France		F.R.G.		U.K.		Japan		Italy	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
GDP (billions)	2,350	2,556	227	252	571	648	764	824	401	515	1,000	1,038	324	393
Imports														
Total Imports (c.i.f.)	207,131	241,195	53,518	58,992	106,794	134,852	157,747	185,853	102,826	120,152	110,622	141,108	77,812	99,702
% of GDP	8.81%	9.44%	23.58%	23.44%	18.71%	20.80%	20.65%	22.55%	25.65%	23.33%	11.07%	13.59%	24.05%	25.39%
Imports from Eastern Europe	990	971	203	214	1,547	1,758	4,095	4,476	1,204	1,147	490	500	1,805	2,257
Imports from U.S.S.R.	874	454	55	51	1,790	3,565	3,893	3,977	1,756	1,829	1,913	1,868	2,063	3,074
Total from Soviet Bloc	1,864	1,424	257	265	3,337	5,323	7,987	8,453	2,959	2,976	2,402	2,369	3,868	5,332
% of Total Imports	.90%	.59%	.48%	.45%	3.12%	3.95%	5.06%	4.55%	2.88%	2.48%	2.17%	1.68%	4.97%	5.35%
% of GDP	.08%	.06%	.11%	.11%	.58%	.82%	1.04%	1.03%	.74%	.58%	.24%	.23%	1.20%	1.36%
Exports														
Total Exports (f.o.b.)	181,801	220,705	55,932	64,939	97,981	111,311	171,518	191,688	90,810	115,176	102,803	129,584	72,124	77,908
% of GDP	7.74%	8.63%	24.64%	25.80%	17.15%	17.17%	22.45%	23.26%	22.50%	22.36%	10.28	12.48%	22.29%	19.84%
Exports to Eastern Europe	2,066	2,340	338	458	2,023	2,182	5,074	5,071	1,169	1,568	1,070	1,160	1,415	1,462
Exports to U.S.S.R.	3,607	1,513	654	1,317	2,005	2,465	3,619	4,373	889	1,060	2,442	2,773	1,218	1,276
Total to Soviet Bloc	5,674	3,953	991	1,776	4,028	4,646	8,693	9,444	2,058	2,628	3,512	3,934	2,633	2,737
% of Total Exports	3.12%	1.75%	1.77%	2.73%	4.11%	4.17%	5.07%	4.93%	2.27%	2.28%	3.42%	3.04%	3.65%	3.51%
% of GDP	.24%	.15%	.44%	.71%	.71%	.71%	1.14%	1.15%	.51%	.51%	.35%	.38%	.81%	.70%

All monetary figures except GDP taken from "Statistics of Foreign Trade," Series A, June 1981; OECD, Division des Statistics economiques et des Comptes nationaux.

GDP taken from "Main Economic Indicators," June, 1981; OECD, Division des Statistiques economiques et des Comptes nationaux.

Summary of Trade Between Summit Countries and the Soviet Bloc (U.S. $ millions)

	U.S.		Canada		France		F.R.G.		U.K.		Japan		Italy	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
Imports														
Total Imports (c.i.f.)	207,131	241,195	53,518	58,992	106,794	134,852	157,747	185,853	102,826	120,152	110,622	141,108	77,812	99,702
Imports from Eastern Europe	990	971	203	214	1,547	1,758	4,095	4,476	1,204	1,147	490	500	1,805	2,257
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Total from Soviet Bloc	1,864	1,424	257	265	3,337	5,323	7,987	8,453	2,959	2,976	2,402	2,369	3,868	5,332
% of Total Imports	.90%	.59%	.48%	.45%	3.12%	3.95%	5.06%	4.55%	2.88%	2.48%	2.17%	1.68%	4.97%	5.35%
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Total to Soviet Bloc	5,674	3,953	991	1,776	4,028	4,646	8,693	9,444	2,058	2,628	3,512	3,934	2,633	2,737
% of Total Exports	3.12%	1.75%	1.77%	2.73%	4.11%	4.17%	5.07%	4.93%	2.27%	2.28%	3.42%	3.04%	3.65%	3.51%

Source: "Statistics of Foreign Trade", Series A; May, 1981; OECD, Division des Statistiques economiques et des Comptes nationaux.

Summary of Trade Between Summit Countries and the Soviet Union (U.S. $ millions)

	U.S.		Canada		France		F.R.G.		U.K.		Japan		Italy	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
GDP (billions)	2,350	2,556	227	252	571	648	764	824	401	515	1,000	1,038	324	393
Imports														
Total Imports (c.i.f.)	207,131	241,195	53,518	58,992	106,794	134,852	157,747	185,853	102,826	120,152	110,622	141,108	77,812	99,702
% of GDP	8.81%	9.44%	23.58%	23.44%	18.71%	20.80%	20.65%	22.55%	25.65%	23.33%	11.07%	13.59%	24.05%	25.39%
Imports from U.S.S.R.	874	454	55	51	1,790	3,565	3,893	3,977	1,756	1,829	1,913	1,868	2,063	3,074
% of Total Imports	.42%	.18%	.10%	.08%	1.67%	2.64%	2.47%	2.14%	1.71%	1.52%	1.73%	1.32%	2.65%	3.08%
% of GDP	.04%	.02%	.02%	.02%	.31%	.55%	.51%	.48%	.44%	.35%	.19%	.17%	.64%	.78%
Exports														
Total Exports (f.o.b.)	181,801	220,705	55,932	64,939	97,981	111,311	171,518	191,688	90,810	115,176	102,803	129,584	72,124	77,908
% of GDP	7.74%	8.63%	24.64%	25.80%	17.15%	17.17%	22.45%	23.26%	22.50%	22.36%	10.28	12.48%	22.29%	19.84%
Exports to U.S.S.R.	3,607	1,513	654	1,317	2,005	2,465	3,619	4,373	889	1,060	2,442	2,773	1,218	1,276
% of Total Exports	1.74%	.69%	1.17%	2.03%	2.04%	2.21%	2.11%	2.28%.	.98%	.92%	2.38%	2.14%	1.69%	1.64%
% of GDP	.13%	.06%	.29%	.52%	.35%	.38%	.47%	.53%	.22%	.21%	.24%	.27%	.38%	.33%

All monetary figures except GDP taken from "Statistics of Foreign Trade," Series A, June 1981; OECD, Division des Statistics economiques et des Comptes nationaux.

GDP taken from "Main Economic Indicators," June, 1981; OECD, Division des Statistiques economiques et des Comptes nationaux.

Principle Agriculural Exporters to the U.S.S.R.: Trade Summary (U.S. $ millions)

	U.S.		Canada		Australia		New Zealand		Argentina	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
GDP (billions)	2,350	2,556	227	252	121	140	21	25	105	145
Imports										
Total Imports (c.i.f.)	207,131	241,195	53,518	58,992	16,536	20,212	4,566	5,466	6,700	10,500
Imports from U.S.S.R.	874	454	55	51	65	18	8	12	31	45
% of Total Imports	.42%	.18%	.10%	.08%	.39%	.09%	.16%	.21%	.46%	.43%
Exports										
Total Exports (f.o.b.)	181,801	220,705	55,932	64,939	18,633	22,063	4,710	5,262	7,810	8,028
% of GDP	7.74%	8.63%	24.64%	25.80%	15.44%	15.78%	22.01%	21.39%	7.45%	5.54%
Exports to U.S.S.R.	3,607	1,513	654	1,317	563	1,129	197	226	415	1,800
% of Total Exports	1.74%	.69%	1.17%	2.03%	3.02%	5.12%	4.19%	4.29%	5.31%	22.42%
% of GDP	.13%	.06%	.29%	.52%	.47%	.81%	.92%	.92%	.40%	1.24%
Agricultural Trade										
Total Agricultural Exports	34,745	41,256	5,536	6,870	8,308	6,300	3,118	2,400	5,500	5,300
Ag. Exports to U.S.S.R.	2,855	1,047	370	1,111	512	1,080	197	220	410	1,780
% of Total Ag. Exports	8.22%	2.54%	6.68%	16.20%	6.16%	19.05%	6.32%	5.80%	5.76%	33.58%
% of Exports to U.S.S.R.	79.15%	69.19%	56.61%	84.30%	91.00%	95.00%	99.00%	99.00%	99.00%	99.00%
% of Total Exports	1.57%	.47%	.66%	1.71%	2.75%	5.40%	4.29%	4.00%	5.25%	22.20%

Sources:
"Statistics of Foreign Trade," Serie A, June 1981; OECD, Division des Statistics economiques et des Comptes nationaux.
"Main Economic Indicators," June, 1981; OECD, Division des Statistics economiques et des Comptes Nationaux.
U.S. Department of Agriculture, Economics and Statistics Service. When verifiable, "Agricultural Exports" include live animals, food, feed, beverages, and tobacco.
Other U.S. Government Estimates.

Senator **Bradley**. Would you support a consortium of Western financial institutions refinancing the Polish debt?

Secretary **Haig**. I think that the amount of refinancing already done by the West has been substantial. We have been involved in about $700 million ourselves.

Senator **Bradley**. So is that no?

Secretary **Haig**. The answer to it is that we will have to deal with this problem continuously in the period ahead, for a substantial period of time, and I am just not sure how best to do it; but I think we have the obligation to do so, and we must be prepared.

Senator **Bradley**. We must be prepared to refinance?

Secretary **Haig**. We have to be prepared in the period ahead to be responsive to the internal Polish needs, in both the debt servicing area, in the food stuff area, to do the best we can, if we are convinced that the internal reforms of the Polish Government are effective and promising in respect to a termination point. And if the East itself, and the Soviet Union in particular, continue to carry their share of this tremendous burden.

Senator **Bradley**. Specifically, have we made any commitment to provide food credits to the Poles?

Secretary **Haig**. Well, we have provided substantial food credits this past year, and we are considering additional credits, yes.

Senator **Bradley**. Do you support Polish membership in the IMF?

Secretary **Haig**. Well, I think this is a question for the Polish Government and for the Polish people to decide.

Senator **Bradley**. Do you see it is in the interest of the United States for Poland to become a member of the IMF?

Secretary **Haig**. I think that is more important that we answer the question in the context of whether or not they as a people and a government wish to be, and I think we should be receptive providing they meet the obligations, so the answer is probably.

Senator **Bradley**. So the answer is yes?

Senator **Haig**. Probably.

Senator **Bradley**. Well, one of the things that concerns me, and I was particularly pleased to hear your concerns expressed as well, is the degree to which we have become strategically vulnerable to any number of actions while pursuing initially what seems to be a reasonable economic course. By expanding trade with the East and expanding credits, our whole financial system becomes strategically vulnerable, as you said, if there is a trade cutoff from the West, it is going to imperil a number of financial institutions that have large credits to the East outstanding.

What specifically is the United States doing to try to assure that in such a crisis scenario, where there is a curtailment of trade, and therefore, a major threat to Western financial institutions, what are we doing to insure the continuing viability of those financial institutions?

Secretary **Haig**. Well, I think the most important aspect of the response is to recognize where the greatest vulnerabilities are, and then you will find that the ability of the Federal Government to affect them is somewhat limited.

I was in on the original consideration of the provision of credit to the Soviet Union in the early seventies. We were talking in the neighborhood of $25 to $30 billions in credit.

In subsequent periods, with Jackson-Vanik and what have you, this issue was largely turned over to the private sector and private banking and lending institutions here at home and in Western Europe, and since that time that debt has been estimated to be approaching a level of $70 billion.

Now, I do not have to tell you, Senator, as things get tense, as the Polish situation develops, the knuckles of our private institution officials get quite white on this subject, and that is the best way to govern this issue—to be sure that all of our private institutions on both sides of the Atlantic and the officials who manage their affairs recognize the vulnerabilities they themselves are creating.

Senator BRADLEY. So are you saying that the Government, therefore, has no responsibility for the situation?

Secretary HAIG. No. The responsibility is to articulate as I have here today, that the consequences of the Soviet invasion of Poland would be dramatic, and long lasting, and it would indeed affect beyond question the institutions which your question addresses.

Senator BRADLEY. So my question is, other than calling attention to the grave risks that exist out there for private institutions, does the Government have any other responsibility to insure the continued health of those financial institutions?

I mean, I have talked to a number of bankers who say what we need is a little discipline in this system, what we need is for one of these banks to fail, without bringing the whole house of cards down.

Now, what are you doing to assure that the whole house of cards will not come down?

Secretary HAIG. Well, I do not want to portray myself as the greatest living expert on that subject: maybe Don Regan would be better able to answer your question.

I do think that contingency considerations have got to be included when restrictions of the kind you are talking about are imposed, so that we will understand what the costs and the impact will be; that does not preclude the responsibility of the Government to look for solutions to deal with the consequences if we are faced with them.

Senator BRADLEY. Mr. Chairman, one more question. Who in government now is making those contingency plans?

Secretary HAIG. Well, I think you will find that the Secretary of the Treasury is very much aware of the vulnerabilities. I think our European partners are very much aware of the vulnerabilities. I am not sure that all has been done that might be done to deal with it.

Senator BRADLEY. Thank you.

Senator DANFORTH. Senator Byrd, you wanted to ask a question of clarification.

Senator BRADLEY. Mr. Chairman, may I please, before I yield, request of you, that we ask the administration if necessary in closed session, to bring to us their latest contingency plans for this possible, very dangerous scenario.

I think it is a very real responsibility, and I would request that perhaps we could make those arrangements where we could hear the latest thinking on this matter, since if there is anything that will torpedo the President's economic plan, it is a crisis in Europe where the financial system is in jeopardy.

Senator DANFORTH. Senator Byrd, did you have a question?

Senator BYRD. May I ask a question for clarification?

Mr. Secretary, the $70 billion figure which you mentioned a moment ago, is that entirely in loans to Eastern bloc countries?

Secretary HAIG. Yes. That is loaned to the East, and I do not even know if the figure is hard enough to give it much veracity, because it is a very difficult figure to establish, given the diversity of the sources, but I have seen several estimates that put it in that range.

Senator BYRD. Thank you.

Senator DANFORTH. Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, I am concerned that more and more economic policy and economic forces in trade patterns drive foreign policy and national security policy today than perhaps was the case several years ago, and I am also concerned that this will increase in the next few years.

Obviously in Ottawa you talk about interest rates and its effects, and there has been some discussion this morning on energy problems and security arrangements, and we also learned that Japan had planned for the future years ago, looking at how to penetrate the American markets with computers and other forms of computer technology and auto sales, and so forth. I am a little concerned that a lot of the discussions has been on an ad hoc basis, and that the United States is reacting to world events, it is reacting to economic events.

I applaud your strategic trade controls and contingency planning, but to a large degree that is reacting too, it is reacting to the Soviet Union, and reacting to Soviet Union adventurism. Sometimes Americans are faulted for having short attention spans, we think too much in the present, we do not think nearly enough to make plans for the future.

I am curious as you sit back and look down the road, where you think the U.S. economy should be moving, what direction it should be moving in to take advantage, comparative advantages, so that we build up a stronger economy at home? Are there certain areas that we should concentrate on?

My second question really is in respect to national security. Are there not ways in which the Department of State and American trade policy leaders can be more on the offensive in Africa, and in South America, in pushing or promoting those countries economically, much more than we have in the past, instead of looking so much at them largely in military terms, from the national security point of view? Could you give me your thoughts, where we are going, more fundamentally where we should be going, and how we can encourage American business to move into those directions?

Secretary HAIG. Well, of course, there are a number of short-term incentives——

Senator **Baucus**. If I might, I am more concerned about the long-term, where are we headed by the year 2000, where should we be, where should the U.S. economy be.

Secretary **Haig**. Well, I think, Senator, I have watched the evolution of the world since the conferences following the Second World War, and the intermixing and the interlocking, the interdependence of both developed and developing nations, the pace of which has picked up in recent years. For example, the trading patterns of many of our developed Western partners have changed substantially—as have our own; if one looks at Australia and New Zealand, where I have just visited, their largest markets today are totally different than those that they had two decades ago.

They are no longer dependent on Europe. They are dependent on developing nonalined states of the Middle East, Japan. We in the United States have seen to an increasing degree our own trade patterns shifting from the developed to the developing world, and I see future patterns emerging in the direction of greater and not less interdependence. I think by any measure or criteria you care to apply—access to strategic materials, consumer patterns—interdependence is an inevitable, growing factor and I think that is one of the underpinnings of the reaffirmation by the the President recently of our adherence to free trade, and to broadening and strengthening the ability to conduct that kind of trade.

Senator **Baucus**. I understand all of that. I hear that, but that is procedural rather than substantive.

I am curious as to where you think we should be going. I do think that the State Department has not thought much about this, and I do think that trade does take a second seat by and large to other issues that the State Department has jurisdiction over, but I strongly encourage the State Department and other agencies concerned with trade to think a little more long term, as to where we should be substantively.

Japan years ago saw that, if it was going to survive, because it was 100 percent dependent on energy, and because it had to penetrate foreign markets, saw that it had to copy a lot of American inventions and do a better job and penetrate American markets, and that is one reason why Japan is doing so well.

Secretary **Haig**. Well, let me suggest, Senator, we do look ahead, and I can assure you that we do.

In fact, I noticed one aspect of your question which suggested perhaps a preoccupation with the security needs of the developing world, and some kind of an ignorance with respect to the socioeconomic needs of the developing world.

Let me suggest to you that it is this administration, this President, in a very farsighted way, who seized the opportunity for a pilot or model case in Jamaica, where people in an unprecedented way cast off the shackles of Marxist-Leninist socialistic strangulation and moved into a democratic society. The President has moved to bring together all of the assets of the United States, private and public, with the collaboration of the nations in the region and nations as far away as Japan and Europe, to work out this problem.

It is this administration which has conceived and worked together, thus far with great success, with Canada, Mexico, and Venezuela, to try to structure a socioeconomic oriented development plan for the Caribbean Basin, including the Caribbean islands and the Central American republics; it is structured in such a way that flexibility, optimal allocation of both public and private sector assests, and recipient nation attitudes and needs will shape the character of that program.

This is unprecedented, and I think it is an extremely promising long-term approach, which should be expanded into other regions.

Senator BAUCUS. I appreciate that.

Secretary HAIG. Well, I call that long-range planning.

Senator BAUCUS. I encourage more of that planning.

Secretary HAIG. Well, good.

Senator BAUCUS. Much more of that, because I do not think there has been very much, and that is just one example, that is pretty isolated too.

I do not have much time, so let me ask another question of another area, and that is whether you support the provision of the Senate Agriculture Committee which protects against grain embargoes.

Secretary HAIG. I am not sure I understand your question.

Senator BAUCUS. There is a provision in the Senate agriculture bill which essentially says the Department of Agriculture will pay farmers losses up to 100 percent of parity of loan rate, and then also the difference between 100 percent parity and the market price as an alternative.

Secretary HAIG. I am afraid you caught me on my blind side. I have not addressed that issue, so I will have to give you the answer.

Senator BAUCUS. I strongly encourage you to support that provision, and I am sure you will, when you consider it very thoroughly.

[The answer to Senator Baucus' question was subsequently supplied by Secretary Haig:]

Answer. I strongly support the President's position that we must not single out the agricultural sector in any future action to restrict exports. However, the Administration is opposed to legislation which would unduly restrict the President's flexibility in responding to international crises. A requirement that 100 percent parity be paid to farmers in the event that export controls on agricultural commodities were imposed would constitute such an undue restriction because of the large impact on the federal budget of such a measure.

Senator BAUCUS. Thank you very much, Mr. Chairman.

Senator DANFORTH. Senator Grassley?

Senator GRASSLEY. Mr. Secretary, as a Senator from an agricultural State, I want to thank you for your statement and for your testimony on page 7 where you say that you expect Ambassadors to play an enthusiastic role in support of such exports.

Although I have no questions on that policy, I guess I would give you some advice on Midwest America's perception of the State Department. Midwesterns feel the State Department is standing in the way of our export of agricultural products, and I think this sort of statement will overcome that perception.

My first question deals with the fact that the Canadian Government is attempting to take over U.S. energy interests in Canada. We keep being told that discussions on this question are continuing, but I have not seen any substantive progress to date.

Could you tell us where we stand on these discussions, and if they prove to be fruitless, will you support imposing the reciprocity for the Mineral Leasing Act or other similar actions?

Secretary **Haig**. Well, Senator, I am not sure of which particular case you are addressing.

Are you talking about the most current case, or are you talking about the broad policies?

Senator **Grassley**. Well, I am talking about overall policy, but I am saying it is reflected in the immediate case.

Secretary **Haig**. Is that the French-Canadian case that you are referring to?

Senator **Grassley**. No, the Canadian national energy policy.

Secretary **Haig**. Well, in general we have of course discussed that repeatedly with our northern neighbors.

We have, I think, seen some responsive policies that came out as a result of those discussions.

First, the President's first trip to Canada and subsequent discussions we had 2 weeks ago with Prime Minister Trudeau.

I think our Canadian friends are aware of our views, incidentally, they have done some statistical work of their own on this which suggests that the level of magnitude of the abuses is not quite as far reaching as some would think. I am not endorsing this view. There have been some improvements since the dialog started.

The dialog will of course continue, and I know our Canadian friends are aware, that if it does not reflect some improvement, they might well be faced with outcomes which would affect their interests here; I do not think they want that, and I think they are going to conduct themselves accordingly.

Senator **Grassley**. You do not know how far we would go then in reacting, like would we impose the reciprocity clause of the Mineral Leasing Act?

Secretary **Haig**. No, I think it is too sensitive an issue for me to get out in front of the situation.

Senator **Grassley**. I appreciate that.

A little bit along the same line, but in a more general vein, I want to first of all tell you that I think it would only be fair that if a foreign corporation attempts to take over a U.S. firm, that foreign company should be required to meet the same marginal requirements that are required to meet the U.S. firm that seeks to take over another U.S. firm.

Our colleague from Kansas, Senator Kassebaum, and others have legislation which would require that foreign firms should meet the same marginal requirements as U.S. firms, if U.S. firms want to buy a U.S. company.

What do you think of that legislation? If you would disapprove of the legislation, do you think existing law is all right, or should there be some changes in existing law?

Secretary **Haig**. Well, Senator, I have not had an opportunity to study that legislation with the care that I should to give you a definitive reply.

I think in general I am comfortable with the prospect and the proposition that acquisition policy should impose responsibilities comparable to those facing U.S. corporations. I would apply that here at home, but I would also apply it abroad, because we have run into the counter of that. I have just left the Presidency of a multinational, where we discovered that the policies that we ran into in potential investment markets abroad were equally worrisome.

Senator **Grassley**. What you are really saying then, is that a foreign company buying a U.S. company should meet the same requirements of a U.S. company purchasing a U.S. company. And that if the U.S. company goes overseas, that we would have to meet the same requirements that are domestic requirements in that foreign country. As an example a domestic German company taking over another company?

Secretary **Haig**. I agree in principle completely with your question and its premise.

Senator **Grassley**. OK.

I have another question that involves just generally embassy involvement, or I suppose indirectly our own State Department involvement in effectuating commercial sale overseas.

For instance, we know that President Reagan rescinded former President Carter's leprosy letter, and although this letter only deals with military sales, I am anxious to know the administration's position on assisting American firms in competing effectively abroad?

I'll give you an example many businessmen who deal overseas have stated that their foreign competitors have had foreign ministers or foreign ministries come in and help them secure a contract. These competitors' governments will assist them in closinq a deal and assisting the sale, for example, providing incentives of loans and lower interest rates. Another example of the administration's awareness of our export situation is the extra support they are lending to the Export-Import Bank contrary to their attitude 5 or 6 months ago.

What is our involvement, and I guess particularly I would like to ask, is there any change in this administration which will assist our commercial enterprises?

Secretary **Haig**. First, Senator, I feel very strongly, having been at least recently, heavily engaged in the commercial world abroad—I think some 60 percent of our corporate work in international investment markets, investment activity—that it is the responsibility of the Department of State to be a catalyst, an advocate, and an enhancer of American commercial enterprises abroad, to be a receptacle, if you will, an entry point for American entrepreneurs who need help abroad. This is one of the things that concerns me, Senator, about the American presence abroad, and especially in our embassies, where we find the State Department today at the same manning level that it had in the early 1960's. I see our embassies, our commercial Counselor offices closing one after another, and I assure you that you cannot achieve what you are seeking as we shrivel up the American presence abroad. I am very concerned about it, and I expressed that concern within the channels of the executive branch, but we need the support of the House and the Senate to be sure that we are not engaged in self-defeating policies, with respect to the very outcomes that you seek.

Now, in the near-term, we are seeking and supporting policies in the State Department, to try to remove the disincentive for American business to go abroad. There are many disincentives; one, for example, is a tax policy of the Federal Government, where our employees abroad are taxed at levels that make it less than attractive for us to invest abroad.

Senator GRASSLEY. We are going to change that.

Secretary HAIG. I wish you luck, and I support you on it, and we support you.

We would like to see the Corrupt Practices Act, and some of the regulatory aspects of it changed. We want to remove some of the uncertainties which injure legitimate business transactions. I was the fellow in my own corporation who was ultimately responsible for the application of the Corrupt Practices Act, and today it is in need of repair, and we support those reforms.

Senator GRASSLEY. I want to assure the Secretary that in principle I support those changes in legislation, but is it as simple, for instance, as whether or not the Congress is providing enough funds for additional personnel in the embassies to serve as necessary liaison for our commercial interests overseas, or does it not require some change in policy within the State Department.

It seems to me from complaints from business contacts I have had, is that we do not service commercial interests overseas to the same extent that our foreign competition is serviced by their embassies. That is why my question is, are there any changes in this administration that are different from previous administrations?

Secretary HAIG. Yes; absolutely, Senator, and I think I would like to send you a copy of the letter that I have sent to all of our Ambassadors, which addresses this specific subject. I am very much aware of the traditional concern of the American business community, that the State Department is an obstacle rather than a facilitator of their activities abroad, and we are very sensitive about that. I have talked to Secretary Baldrige about it, we have met on it and discussed it repeatedly, and I can assure you that this administration is moving very, very positively in the direction that your question is suggesting.

Senator DANFORTH. Mr. Secretary, I have promised to get you out of here by 5 minutes to 12.

There are 5 minutes left. I would like to ask you another question, and if we have time, another Senator may want to ask you one more as well.

The basic position of our administration is to let market forces work, not to try to protect specific industries, whether they are dying or startup industries.

It has been referred to, perhaps unfairly so, as survival of the fittest, but that is the general direction the administration wants to move in,

Should there be an exception to that policy for certain industries which are deemed to be in the national security interest, and is there a way to define what is and what is not of a national security interest?

Secretary HAIG. Well, it is a terribly complex question to answer and to respond to.

Senator DANFORTH. Because we are down to the wire, would you like to do it in written form?

Secretary **Haig**. Yes; I think it would be easier and more efficient to do it that way.

Senator **Danforth**. OK, I would appreciate it. There may also be other Senators who would like to submit written questions. I would appreciate it if you could answer that one, in particular, whether or not there should be an exception, and if the answer is yes, how do we go about defining it.

[The following was received for the record:]

Question. "The basic position of our Administration is to let market forces work, don't try to protect specific industries, whether they are dying or startup industries * * * Should there be an exception to certain industries which are deemed to be in the national security interest, and is there a way to define what is and what is not of a national security interest?"

Answer. The statement of U.S. Trade Policy delivered by Ambassador William E. Brock, United States Trade Representative, before a joint oversight hearing of the Senate Committee on Finance and the Senate Committee on Banking, Housing and Urban Affairs on July 8, contained the following:

"Our policies toward (industrial adjustment problems) will take into account the fact that the economic vitality of certain sectors of our domestic economy is clearly essential to national security."

We are not now confronted with a situation in a particular industry in which our national security requires an exception to letting market forces work. But it is prudent to bear in mind that such a situation might develop. If a serious industrial adjustment problem should arise for which it would be reasonable to consider national security ramfications, the Cabinet and the President would have to consider at that time the extent to which such security considerations should affect government policy toward industrial adjustment.

Senator **Danforth**. Senator Heinz?

Senator **Heinz**. Mr. Secretary, you have indicated that the State Department is going to be quite aggressive in pursuing the trade rights of the United States, even while other people make it difficult for us to do so.

In that connection, we are engaged in what has been for the last few years a monumentally unsuccessful negotiation to limit export credit subsidies.

A meeting is again planned of the OECD for this fall. One of the bargaining elements that we have is a bill pending in the Congress before my Banking Committee, that is my bill, to create a $1 billion war chest, which would trigger in the event the President is unable to certify that we are making substantial progress in wrapping up an export subsidy credit agreement.

Does the State Department look with favor upon that bill as a part of our strategy to obtain such an agreement?

Secretary **Haig**. I cannot answer that question.

Senator **Heinz**. Secretary Baldrige thinks it is a good bill. Ambassador Brock thinks it is a good bill.

I do not want to influence you.

Secretary **Haig**. Well, it would be hard for me to deviate from my two colleagues. [Laughter]

To be honest, Senator, I also think this is a subject that we have fought consistently and will continue to fight on. It was a key topic at Ottawa, and there we got agreement in the communique to address this issue with greater intensity and with a view towards eliminating these subsidies.

Senator **Danforth**. Senator Grassley, you have 1 minute.

Senator **Grassley**. OK.

Is our relationship with Taiwan so sensitive that a grain agreement with a business in Des Moines, Iowa, with Taiwan which was to have been to be signed in May or June, has been temporarily called off because of terminology. I refer to the State Department requesting that the contract read the "Government of Taiwan" rather than, "The Republic of China, the verbage that was used in referring to Taiwan.

Do our agri-business relationships with Taiwan have to be conducted on that precise kind of language? Are things that sensitive, or is there anything we can do so they do not have to be?

Secretary **Haig**. Well, that is up to us. We cannot delude ourselves, because this is an extremely sensitive question, and we must deal with it, and our failure to do so could have very serious consequences for American interests.

Senator **Grassley**. That is all you can say?

Secretary **Haig**. I can say it is a very sensitive subject.

Senator **Danforth**. Mr. Secretary, you have been most helpful. Thank you very much.

[Whereupon, the committee was adjourned at 11:55 a.m.]

[The prepared statement of Secretary Haig and his answers to questions submitted by Senator Heinz follow:]

STATEMENT OF ALEXANDER M. HAIG, JR.
SECRETARY OF STATE
BEFORE THE SUBCOMMITTEE ON
INTERNATIONAL TRADE
OF THE COMMITTEE ON FINANCE
UNITED STATES SENATE
WASHINGTON, D.C.
JULY 28, 1981

Mr. Chairman:

Let me thank you for this opportunity to discuss key elements of the Administration's approach to international trade, and the part it plays in US foreign policy. International economic developments are of central concern to the State Department and every Secretary of State must devote a great deal of time and attention to them. I am therefore particularly grateful for your invitation to testify on our international economic policy before this Committee.

President Reagan has recognized that a strong American economy is the cornerstone of our national security. The strength we seek depends first and foremost on the success of the President's economic recovery program. A prosperous, well-functioning world trading system will make an important contribution to that success.

As my Cabinet colleagues have already said in their earlier appearances before this Committee, the Administration's approach to trade is shaped by the recognition that trade is an increasingly powerful source of innovation and growth for the American economy. We gain from access to the world's markets and the spur of international competition. Our producers and consumers benefit from access to foreign goods and raw materials. Trade clearly reinforces the President's domestic efforts to reduce inflation, to increase production, and to expand employment.

In addition trade can contribute to mutually beneficial cooperation among nations. Healthy trade relations can strengthen friendships and alliances, and can help integrate countries into the market-oriented trading system which has served us so well.

US Trade Policy

Our current trade policy has its roots in historical experience. Following World War II the major industrial nations recognized that the bilateral arrangements and protectionist policies pursued by many nations during the inter-war period had done severe harm to their economies, played havoc with the international economy, and contributed to the frictions and tensions which ultimately led to the outbreak of war. The US and its partners therefore set out to create a new trading system

BASED ON FAIR TRADING RULES, ON NONDISCRIMINATION AMONG TRADING PARTNERS, AND ON THE COMMITMENT TO REDUCE TRADE BARRIERS -- ESPECIALLY HIGH TARIFFS.

THAT SYSTEM IS EMBODIED IN THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). DESPITE ITS IMPERFECTIONS AND DEPARTURES FROM CERTAIN OF ITS PRINCIPLES, THIS SYSTEM HAS BROUGHT ENORMOUS BENEFITS TO VIRTUALLY EVERY NATION IN THE WORLD AND SERVED AMERICAN INTERESTS WELL. THE DRAMATIC GROWTH IN TRADE SINCE THE WAR HAS STRENGTHENED OUR OWN ECONOMY AND THAT OF OUR TRADING PARTNERS. US EXPORTS GREW FROM $10.8 BILLION IN 1950 TO $221 BILLION IN 1980. THIS HAS MEANT MILLIONS OF JOBS FOR AMERICAN FARMERS, WORKERS, SHIPPERS, RAILROAD WORKERS, TRUCKERS, LONGSHOREMEN, INSURERS, AND BANKERS -- ALL OF WHOM HAVE DIRECTLY BENEFITED. AND, WHILE WE OFTEN FACE DIFFICULT PROBLEMS WITH SOME OF OUR DEVELOPED COUNTRY TRADING PARTNERS, WE WOULD BE CONSIDERABLY WORSE OFF IF WE HAD CHOSEN A TRADING SYSTEM BASED ON MORE RESTRICTIVE PRINCIPLES AND RULES. SUCH A SYSTEM MIGHT WELL HAVE BROUGHT PROLONGED ECONOMIC WEAKNESS TO OUR TRADING PARTNERS AND, AS A CONSEQUENCE, POOR MARKETS FOR OUR EXPORTS, ECONOMIC INSTABILITY IN EUROPE, AND REDUCED WESTERN RESOURCES FOR DEFENSE. INEVITABLY, THE US WOULD HAVE HAD TO BEAR A MUCH LARGER DEFENSE BURDEN.

TODAY, THERE ARE STRAINS IN THE SYSTEM. COMPETITION AMONG DEVELOPED COUNTRIES AND WITH DEVELOPING COUNTRIES IS MORE INTENSE THAN IT WAS YEARS AGO. AND SLOWER GROWTH IN MANY DEVELOPED NATIONS INCREASES THE DIFFICULTY OF ADJUSTING TO RAPID INCREASES IN IMPORTS.

IN THE FACE OF KEENER COMPETITION, MANY COUNTRIES FACE ENORMOUS PRESSURES TO PROTECT INDUSTRIES BY RESTRICTING IMPORTS OR SUPPORTING NONCOMPETITIVE EXPORTS. THEY ARE TEMPTED TO WORK OUT BILATERAL TRADE ARRANGEMENTS WHICH PROTECT CERTAIN PATTERNS OF TRADE OR LIMIT TRADE. INVESTMENT PRACTICES ARE INCREASINGLY USED AS A MEANS OF FORCING INCREASED PROCUREMENT OR INCREASED EXPORTS. BARRIERS EXIST IN SERVICES, WHERE THE US IS VERY COMPETITIVE. CERTAIN COUNTRIES THAT BENEFIT GREATLY FROM THE TRADING SYSTEM HAVE FAILED TO OPEN THEIR MARKETS ADEQUATELY, EVEN WHILE THEY TAKE ADVANTAGE OF OPEN MARKETS IN OTHER COUNTRIES.

UNLESS WE RESOLVE THESE THESE PROBLEMS AND DISTORTIONS, THEY WILL SEVERELY WEAKEN THE INTERNATIONAL TRADING SYSTEM. EFFORTS TO STRENGTHEN OUR DOMESTIC ECONOMY WILL BE COMPLICATED, THE WORLD ECONOMY WILL BE DISRUPTED, AND INTERNATIONAL COOPERATION AMONG BOTH THE DEVELOPED AND DEVELOPING NATIONS WILL BE THREATENED.

THE OTTAWA SUMMIT PROVIDES A FRESH IMPETUS TO ADDRESS THE PROBLEMS AND DISTORTIONS IN INTERNATIONAL TRADE. BUT THIS MOMENTUM MUST BE SUSTAINED BY FIRM LEADERSHIP, NOT JUST BY ONE OR TWO NATIONS BUT BY THE INDUSTRIAL AND DEVELOPING NATIONS TOGETHER.

THE US WILL PLAY ITS PART. PRESIDENT REAGAN HAS COMMITTED THIS ADMINISTRATION TO THE SUPPORT OF AN OPEN TRADING SYSTEM ON THE BASIS OF AGREED RULES. AT THE SAME TIME, WE HAVE ASKED FOR SIMILAR UNDERTAKINGS FROM OTHER COUNTRIES. WE WERE THEREFORE PLEASED THAT WE AND OUR PARTNERS AT OTTAWA AGREED TO "REAFFIRM OUR STRONG COMMITMENTS TO MAINTAINING LIBERAL TRADE POLICIES AND TO THE EFFECTIVE OPERATION OF AN OPEN MULTILATERAL TRADING SYSTEM. . . . THAT WE WILL WORK TOGETHER TO STRENGTHEN THE SYSTEM IN THE INTEREST OF ALL TRADING COUNTRIES." THE MEETING OF THE MEMBERS OF THE GATT AT MINISTERIAL LEVEL DURING 1982, AND THE STUDY OF THE TRADE PROBLEMS OF THE 80'S BY THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) PROVIDE EXCELLENT OPPORTUNITIES TO REDUCE AND REMOVE KEY

TRADE DISTORTIONS. CLOSE CONSULTATION AMONG MINISTERS OF THE US, EC, AND JAPAN CAN CONTRIBUTE SIGNIFICANTLY TO THE SUCCESS OF BOTH EFFORTS, AS THEY DID TO THE ACHIEVEMENTS OF THE TOKYO ROUND.

FOR THE SAKE OF OUR OWN ECONOMY, WHICH WILL BENEFIT FROM GENUINELY OPEN WORLD TRADE, AND OF THE WORLD ECONOMY, WE AND OUR TRADING PARTNERS MUST TAKE ADVANTAGE OF THESE OPPORTUNITIES.

PROMOTING U.S. EXPORTS

JUST AS WE WILL WORK TOWARD MAINTAINING AND IMPROVING THE WORLD TRADING SYSTEM TO INCREASE OPPORTUNITIES FOR US EXPORTS AND FOR MUTUALLY BENEFICIAL TRADE AMONG ALL NATIONS, SO WE WILL WANT TO HELP OUR CITIZENS TO TAKE ADVANTAGE OF THESE OPPORTUNITIES. FUNDAMENTAL TO OUR EXPORT PROSPECTS IS A STRONG, COMPETITIVE AMERICAN ECONOMY. WITHOUT THIS, THE BEST OF INTENTIONS AND THE BEST OF EXPORT PROGRAMS CANNOT FULLY SUCCEED. AS THE PRESIDENT'S PROGRAM BRINGS DOWN OUR RATE OF INFLATION AND STIMULATES OUR PRODUCTIVITY, IT WILL PERMIT OUR FIRMS TO IMPROVE THEIR INTERNATIONAL COMPETITIVENESS.

SUCH EFFORTS NEED EFFECTIVE GOVERNMENT SUPPORT. THE U.S. TRADE REPRESENTATIVE, BILL BROCK, HAS CONVEYED TO THIS COMMITTEE THE ADMINISTRATION'S STRONG ATTEMPTS TO REDUCE SELF-IMPOSED EXPORT DISINCENTIVES AND TO IMPROVE US EXPORT PROMOTION PROGRAMS. I FULLY SUPPORT THE WORK OF AMBASSADOR BROCK AND OF SECRETARIES BALDRIGE AND BLOCK TO INCREASE EXPORTS. IN MAY, I SENT A CABLE TO OUR AMBASSADORS ABROAD ASKING THEM PERSONALLY TO TAKE THE LEAD AT THEIR POSTS AND TO DEPLOY THEIR ENTIRE COUNTRY TEAMS -- NOT JUST ECONOMIC AND COMMERCIAL OFFICERS -- IN THIS EFFORT. AND AS A MAJOR PART OF THIS PROGRAM, I HAVE ALSO EMPHASIZED TO OUR AMBASSADORS THE IMPORTANCE I ATTACH TO INCREASING US AGRICULTURAL EXPORTS. I EXPECT THEM TO PLAY AN ENTHUSIASTIC ROLE IN SUPPORTING SUCH EXPORTS.

THE STATE DEPARTMENT ALSO SUPPORTS THE VERY VIGOROUS EFFORTS BEING MADE BY THE DEPARTMENT OF COMMERCE AND THE OFFICE OF THE US TRADE REPRESENTATIVE TO INSURE THAT OTHER COUNTRIES LIVE UP TO THE SPIRIT AND THE LETTER OF THE TOKYO ROUND AGREEMENTS. OTHER COUNTRIES EXPECT US TO DO THE SAME. AND YOU CAN BE SURE THAT OUR TRADE NEGOTIATORS WILL BARGAIN HARD TO REDUCE IMPEDIMENTS TO US EXPORTS.

TRADE WITH DEVELOPING COUNTRIES

LET ME NOW ADDRESS THE SPECIFIC ISSUES RELATED TO TRADE WITH THE DEVELOPING NATIONS.

TRADE BETWEEN THE US AND THE DEVELOPING COUNTRIES HAS GROWN RAPIDLY OVER THE LAST DECADE. U.S. EXPORTS TO THESE COUNTRIES HAVE GROWN FROM $10.8 BILLION IN 1970 TO $81 BILLION IN 1980. THE DEVELOPING COUNTRIES TAKEN TOGETHER ARE NOW A LARGER EXPORT MARKET FOR US GOODS THAN JAPAN AND THE EUROPEAN COMMUNITY COMBINED, ACCOUNTING FOR 36 PERCENT OF OUR EXPORTS. THESE COUNTRIES HAVE ALSO BECOME FORMIDABLE COMPETITORS IN OUR MARKETS. SOME HAVE ACCEPTED MULTILATERAL TRADING RULES; OTHERS HAVE BEEN RELUCTANT TO DO SO. SOME HAVE BENEFITED ENORMOUSLY FROM AN OPEN TRADING SYSTEM; OTHERS ARE SO POOR THAT THEY HAVE VERY LITTLE TO EXPORT.

OVER THE NEXT DECADE, ACCESS OF DEVELOPING COUNTRY EXPORTS TO DEVELOPED COUNTRY MARKETS IS CRUCIAL FOR THE GROWTH THAT IS FUNDAMENTAL TO THE ECONOMIC AND POLITICAL STABILITY OF THE DEVELOPING WORLD. FOR MANY OF THE DEVELOPING COUNTRIES, EXPORT EARNINGS, COMBINED WITH PRIVATE INVESTMENT, ARE FAR MORE IMPORTANT THAN OFFICIAL AID FLOWS. AND FOR THE US AND OTHER DEVELOPED COUNTRIES, OPEN AND FLOURISHING MARKETS IN THE DEVELOPING WORLD WILL BE INCREASINGLY IMPORTANT TO OUR OWN EXPORT PERFORMANCE, AND TO THE DOMESTIC ECONOMY.

Developed and developing countries will have to work more closely than ever in the GATT to address the problems of the trading system. We intend to maintain open markets for developing country products and we expect developing nations that have demonstrated international competitiveness to open their markets to our products. Together we need to insure access to our markets for the products of the poorer nations, to broaden developing country participation in the GATT codes, and to address the distortions -- such as those imposed by investment performance requirements -- to international trade. An open trading system, based on common adherence to agreed rules, is an objective shared by developed and developing countries. We must work, in the context of the GATT, to attain it.

More specificially, we have devoted considerable attention over recent months to the Caribbean Basin. We see a special need to work with countries of the region to promote the well-being of its people. We have begun careful and thorough discussions with Canada, Mexico and Venezuela, along with other interested countries, about the best approach to promote economic progress. We have also begun intensive consultations with the Congress, from which we welcome advice and suggestions.

OUR OVERALL AIM IS TO CREATE AN ACTION PROGRAM FOR REGIONAL DEVELOPMENT. IT IS TOO EARLY TO DEFINE THE FINAL FORM OF THE PROGRAM. MUCH WILL DEPEND ON OUR CONSULTATIONS WITH OTHER COUNTRIES AND THE CONGRESS. TRADE LIBERALIZATION, DOMESTIC AND FOREIGN INVESTMENT, AID, AND ACTIONS BY THE CARIBBEAN COUNTRIES TO STIMULATE THEIR OWN GROWTH AND DEVELOPMENT ARE ALL POTENTIAL COMPONENTS.

EAST-WEST TRADE

THE LAST AREA I WOULD LIKE TO COVER IS EAST-WEST TRADE. HERE THE LINKS BETWEEN TRADE POLICY AND FOREIGN POLICY ARE CLEAR. WE ARE NOT DEALING WITH FREE MARKET FORCES, AND WE FACE MANY ISSUES IN WHICH SECURITY AND POLITICAL PRINCIPLES MUST OVERRIDE COMMERCIAL CONCERNS.

OUR CENTRAL OBJECTIVES IN THIS AREA ARE TWO-FOLD. FIRST, OUR TRADE RELATIONS, AND OUR BROADER ECONOMIC RELATIONS, MUST REINFORCE OUR EFFORTS TO COUNTER THE SOVIET UNION'S MILITARY BUILD-UP AND ITS IRRESPONSIBLE CONDUCT IN A NUMBER OF AREAS OF THE WORLD. WHILE CLEARLY WE HAVE COMMERCIAL INTERESTS WHICH MUST AND WILL BE TAKEN INTO ACCOUNT, SECURITY CONCERNS MUST REMAIN PARAMOUNT. SECOND, WE MUST STRENGTHEN COOPERATION AMONG FRIENDS AND ALLIES IN THIS AREA. WE CANNOT CARRY OUT AN

EFFECTIVE EAST-WEST ECONOMIC POLICY UNILATERALLY. WE MUST TAKE INTO ACCOUNT THE COMPLEX INTER-RELATIONSHIPS THAT EXIST AMONG OUR ALLIES AND OECD PARTNERS AND AMONG THE INDIVIDUAL COUNTRIES OF THE WARSAW PACT.

OVER THE LAST SEVERAL MONTHS WE HAVE CAREFULLY REVIEWED OUR POLICY ON EAST-WEST TRADE IN THE CONTEXT OF OVERALL EAST-WEST RELATIONS. WE DID SO BECAUSE WE WANTED TO BE AS PRECISE AND AS CLEAR AS POSSIBLE AT THE OTTAWA SUMMIT ABOUT OUR CONCERNS AND ABOUT OUR PROPOSALS FOR ADDRESSING THEM. WE DID SO NOT BECAUSE WE WISHED TO IMPOSE ANY PARTICULAR SOLUTIONS ON THE COUNTRIES REPRESENTED THERE, BUT BECAUSE WE WANTED TO INITIATE A SERIOUS DISCUSSION OF EAST-WEST TRADE RELATIONS AT THE HIGHEST LEVEL.

I WOULD LIKE TO TOUCH BRIEFLY ON TWO MAJOR ELEMENTS OF OUR POLICY:

STRATEGIC TRADE CONTROLS. THE U.S. AND ITS ALLIES HAVE MAINTAINED CONTROLS ON THE EXPORT OF STRATEGIC GOODS AND TECHNOLOGY TO THE SOVIET UNION AND EASTERN EUROPE SINCE 1949. OUR OBJECTIVE HAS BEEN TO RESTRICT THE FLOW OF ADVANCED HARDWARE AND TECHNOLOGY IN ORDER TO PRESERVE OUR TECHNOLOGICAL EDGE AND TO INHIBIT AND PREVENT ADVANCES IN SOVIET MILITARY CAPABILITY.

ON THE BASIS OF OUR POLICY REVIEW, WE CONCLUDED THAT A TIGHTENING OF RESTRICTIONS ON GOODS AND TECHNOLOGY WHICH COULD

UPGRADE SOVIET PRODUCTION IN AREAS RELEVANT TO SOVIET MILITARY STRENGTH WAS BOTH DESIRABLE AND NECESSARY. THE PRESIDENT PRESENTED OUR GENERAL APPROACH TO THE OTHER LEADERS AT OTTAWA, NOT EXPECTING THEIR IMMEDIATE AGREEMENT, BUT STRESSING THE IMPORTANCE HE ATTACHES TO WORKING WITH THEM TO ACHIEVE TIGHTER RESTRICTIONS. WE LOOK FORWARD TO DISCUSSING OUR PROPOSALS, AND THE IDEAS OF OTHER COCOM COUNTRIES, IN COMING WEEKS AND MONTHS AND, IN PARTICULAR, AT A HIGH LEVEL COCOM MEETING THIS FALL.

WE RECOGNIZE THE STRONG POSSIBILITY THAT SEVERAL COUNTRIES WILL DIFFER ON DETAILS AND DEGREE. SOME HAVE MORE EXTENSIVE COMMERCIAL LINKS WITH THE EAST THAN OUR OWN. OTHERS BELIEVE THAT ECONOMIC TIES MODERATE POLITICAL BEHAVIOR. BUT WHILE WE MAY NOT ALWAYS SEE EYE TO EYE ON SPECIFICS, I AM ENCOURAGED BY THE RECOGNITION, EMBODIED IN THE OTTAWA COMMUNIQUE, THAT WE MUST "INSURE THAT IN THE FIELD OF EAST-WEST RELATIONS OUR ECONOMIC POLICIES CONTINUE TO BE COMPATIBLE WITH OUR POLITICAL AND SECURITY OBJECTIVES"...AND THAT WE WILL "CONSULT TO IMPROVE THE PRESENT SYSTEM OF CONTROLS ON TRADE AND STRATEGIC GOODS AND RELATED TECHNOLOGY WITH THE USSR."

I ALSO BELIEVE THAT ANY TIGHTENING OF EXPORT CONTROLS MUST BE ACCOMPANIED BY INCREASED EFFORTS TO POLICE THESE CONTROLS AND TO IMPROVE THE EFFICIENCY OF OUR MANAGEMENT. THE SOVIET UNION AND SOME OF ITS WARSAW PACT PARTNERS ARE ENGAGED IN A MAJOR

EFFORT TO OBTAIN EMBARGOED EQUIPMENT AND TECHNOLOGY. WE AND OUR ALLIES MUST IMPROVE OUR COOPERATIVE ENFORCEMENT EFFORTS. WE HAVE BEGUN DISCUSSIONS WITH OTHER COCOM COUNTRIES TOWARDS THIS END.

WE MUST ALSO MAKE DECISIONS MORE QUICKLY ON REQUESTS BY OTHER COUNTRIES TO SELL ITEMS CURRENTLY ON THE COCOM LIST. FINALLY, WE SHOULD SEEK, WHERE POSSIBLE, TO RELAX RESTRICTIONS ON ITEMS AT THE VERY LOW END OF THE TECHNOLOGY SCALE, THE CONTROL OF WHICH PENALIZES OUR EXPORTERS RATHER THAN THE SOVIETS.

FOREIGN POLICY CONTROLS. A SECOND KEY AREA FOR ENHANCED COOPERATION IS CONTINGENCY PLANNING -- THE NEED FOR THE INDUSTRIALIZED DEMOCRACIES TO REACT CLEARLY TO SOVIET ADVENTURISM AND THE USE OF FORCE.

THE ECONOMIC MEASURES TAKEN AFTER THE SOVIET INVASION OF AFGHANISTAN INDICATE THAT CONTROLS ARE MORE EFFECTIVE WHEN IMPLEMENTED COLLECTIVELY, AND WHEN THE BURDEN IS NOT BORNE DISPROPORTIONATELY BY SPECIFIC SECTORS OR ONLY A SMALL GROUP OF COUNTRIES. COORDINATION SHOULD TAKE PLACE IN ADVANCE OF A CRISIS. MUCH WORK HAS BEEN DONE BILATERALLY AND IN NATO TO ANTICIPATE AND PLAN COMMON APPROACHES FOR CONTINGENCIES. DISCUSSIONS IN OTTAWA UNDERLINED A COMMON INTEREST IN SYSTEMATIC AND SUSTAINED EXCHANGES ON THIS SUBJECT.

These are two of the most important areas of East-West trade relations. We and our OECD partners have strong views on East-West trade relations because of our great concern over the Soviet Union. Over the last several years, there has been an awakening to the common dangers we face and a stronger dedication to deal with these dangers in a more integrated and effective way. Our objective is not to impose our views on our friends and allies, but to make our case firmly and clearly on the basis of common interests with the aim of reaching agreement on a common approach.

Conclusion

To conclude, Mr. Chairman, please accept my thanks for the opportunity to participate in your hearings. I have come here today because of my conviction that our trade policy -- which you and your colleagues are so instrumental in shaping -- has a major bearing on the health of our economy and on our country's place in the world.

An active and effective U.S. trade policy can strengthen our domestic economy and improve our political ties with developed and developing countries alike. An effective trade policy toward the Eastern countries can permit commercial exchanges in certain sectors while insuring that we and our major trading partners limit such exchanges where required by our security interests.

The Department of State and our Ambassadors and officials abroad stand ready to play an active role in support of U.S. trade interests and to work closely with Ambassador Brock and Secretaries Baldrige and Block to support their efforts. We will also pursue close and cooperative working relations with you in the Congress.

Thank you, Mr. Chairman.

1981 SEP -9 AM 8 42

DEPARTMENT OF STATE
Washington, D.C. 20520

8 SEP 1981

Dear Senator Heinz:

I am pleased to forward our responses to the questions you recently sent to Secretary Haig.

Sincerely,

Richard Fairbanks

Richard Fairbanks
Assistant Secretary
for Congressional Relations

Enclosure:

Responses to questions.

The Honorable
John Heinz,
United States Senate.

Q: With respect to developing countries, there has been increasing concern in the Congress that the lion's share of trade benefits provided to LDCs has been going to countries that no longer properly belong in that category, like Taiwan, Korea and Hong Kong. When you talk about the need to maintain open markets for the developing countries, exactly who are you talking about?

A: Our commitment to keep our markets open to the developing countries extends to all LDCs, but the degree to which countries are able to benefit from it depends on their capacity to export to the U.S. In an effort to provide a broader distribution of benefits to LDCs under the Generalized System of Preferences (GSP), the U.S. has introduced a graduation concept whereby advanced developing countries are excluded from duty-free GSP treatment on specific products in which they have exhibited sustained international competitiveness.

Our trade policy with developing countries is influenced by two important factors: 1) Trade is an increasing component of U.S. GNP. Expansion of U.S. exports is made possible, in large part, by the open access we maintain for the products of other countries in the U.S. marketplace. 2) Trade is also an important source of revenue for all levels of developing countries, particularly in the light of diminished development assistance and increased balance of payments problems due to rising oil bills.

Q: With respect to the Caribbean Basin, I'm a little unclear as to what your objectives are there. Can you elaborate? Are they primarily economic or political?

A: The U.S. has become increasingly concerned over the economic problems that face countries in the Caribbean and Central America. These must be resolved, both for humanitarian reasons and because we believe that inadequate economic development and social imbalance are among the root causes of tensions in the region. We foresee an approach which would include the IMF, the IBRD, OECD nations and concerned Latin American countries in a cooperative effort taking place within the existing institutional framework.

We have already opened discussions in Nassau with Mexico, Venezuela and Canada and more informally with many other countries. Both western developed and regional developing countries have expressed an interest in taking part in the formulation of a coordinated effort to achieve growth in the basin. We expect that the initiative developed in consultation with these countries would include elements of trade, investment and direct assistance. The basin countries themselves would act to reduce internal constraints on growth and production. We foresee a major role for the private sector. We do not contemplate security assistance within the initiative, which is essentially a social, economic development effort.

Q: Since most products from the Caribbean nations (87%) already enter the U.S. duty free, I wonder how much more we can do within the parameters of our existing unfair trade practice laws. Is the only concession we have left our willingness to bend those laws in certain cases so dumped or subsidized merchandise could enter the U.S. unimpeded? If so, is that what you intend to propose? If not, what other things can we do?

A: Our efforts to develop a Caribbean Basin initiative do not include steps that would circumvent our unfair trade practice laws. Initially, we are looking at present trade patterns between the Caribbean Basin and the United States to see if there might be some products which could benefit from greater access to the U.S. market under existing legislation (i.e. GSP and Section 124 authority).

Because we are trying to develop a coordinated effort of trade, investment, and aid programs, we also believe that in the long term trade patterns could be improved through the enhancement of the investment climate in the Caribbean. If we are successful in convincing the Basin countries of the need for providing a stable atmosphere for foreign investment, increased trade should follow. Therefore, we are not relying on trade initiatives alone to make the plan work. It is only through the complementary efforts of trade, investment and aid that the region can prosper.

Q: Could you provide in greater detail your views on S.868, the so-called "war chest" bill and its usefulness as a tactical device in our effort to bring an end to export credit subsidies?

A: I fully endorse the objectives of S. 868 in reducing and eliminating export credit subsidies. We have pressed hard for significant increases in minimum interest rates. An important factor in demonstrating our resolve to those countries reluctant to increase rates has been our willingness to match, on a selective basis, their subsidized credits. I believe that the mere existance of the proposal has been helpful in moving negotiations forward.

Negotiations are continuing in the OECD framework. The Ottawa Summit called for the conclusion of these negotiations by the end of the year. We are hopeful that this commitment will soon lead to success.

[By direction of the chairman the following communications were made a part of the hearing record:]

Statement of the Honorable Donald T. Regan
Secretary of the Treasury
before the
Finance Subcommittee on International Trade
and the
Banking Subcommittee on International Finance
and Monetary Policy
United States Senate
July 8, 1981

I welcome this opportunity to discuss U.S. trade policy. The Reagan Administration's approach to trade is integrally related to our overall economic policies, as it must be. International trade is an increasingly vital component of the U.S. economy. Last year, U.S. exports of goods and services amounted to about $345 billion, or 13 percent of the U.S. gross national product, double their share a decade ago. International trade provides jobs for American workers, markets and essential raw materials for U.S. industries, and choice for American consumers. It also provides a healthy stimulus to domestic economic innovation and efficiency, essential to our fight against inflation and our efforts to enhance economic vitality and growth.

Ambassador Brock and Secretary Baldrige have already discussed the basic outlines of this Administration's trade policy. We are firmly committed to a policy of open markets. We reject trade protectionism as inconsistent with our fundamental economic beliefs, counterproductive to our efforts to reduce inflation and improve domestic productivity, and potentially highly detrimental to our export interests. And we seek actively to reduce or eliminate government-imposed barriers -- U.S. and foreign -- to U.S. exports.

I would like to take this opportunity to address U.S. trade policy from the perspective of our broad domestic and international economic policies, and to outline Treasury's special interests in the financial services sector -- including investment, banking, insurance, and export finance.

The U.S. Domestic Economic Program

Without a strong domestic economy, the United States cannot expect to compete at its best either at home or abroad. Rapid inflation reduces the natural comparative advantage of U.S. industries, while a stagnant investment climate and minimal gains in productivity mortgage their future competitive edge, as well.

The program of the Reagan Administration is designed to attack the fundamental economic problems of rampant inflation, slow growth, declining rates of investment, and high levels of unemployment.

It does so through four interrelated policies:

1. A stringent budget policy designed to release resources to the private sector for investment.
2. An economically-oriented, incentive tax policy designed to increase the supply of labor and capital resources -- to encourage work effort, saving and investment.
3. A stable, non-inflationary monetary policy to reduce inflationary expectations and keep inflation permanently under control.
4. A regulatory reform program to eliminate unnecessary

government regulations, and to reduce the inefficiencies and enormous costs they place on private economic activity. President Reagan was elected on the strength of his promise to provide a consistent, long-term program to reshape dramatically the American economy -- to foster a climate that will increase the basic long-term incentives to work, save and invest.

This we can, and must, do with a consistent, long-term set of policies that restore incentives and again place our economy on a path of reduced inflation and increased real growth. These policies are not only essential for our economy at home, but also vital to a strong world economy. They will provide a strong, market-based foundation for the U.S. competitive position in world markets. Early Congressional action on this basic economic program is critical, and I applaud the efforts which the Senate has made to secure its prompt passage.

International Economic Policies

The Reagan Administration's focus on long-term domestic economic policy reform is irrevocably intertwined with our international economic policies. Indeed, our international economic policy is based upon a firm belief that the most important contribution we can make to the global economy is to bring our own domestic economy under control. The world's economies are so closely interrelated -- and ours is so large -- -- that the pace of our own economic growth, our rate of inflation, and pressures for import relief deriving from high unemployment in specific U.S. industries all have a direct impact on the economies and trade of other nations. By getting our own house in order, we can assure a strong, positive U.S. influence on the strength and vitality of the global economy on which we depend in turn.

The President's economic program is structured to achieve a number of important international objectives:

-- Domestic monetary and price stability will contribute to permanently restoring confidence in the dollar and to stability in international and domestic financial markets.

-- A more stable U.S. growth rate will reduce the volatility of U.S. imports and thus contribute to economic stability in other countries.

-- A more dynamic and innovative U.S. economy will help reduce protectionist pressures both in the U.S. and overseas by increasing market opportunities and reducing unemployment.

These are the fundamentals we must concentrate on. We cannot achieve these basic objectives by intervening against the symptoms of weak economic performance. We have to address the fundamentals which determine that performance itself.

Our trade policy draws upon and directly complements the market-oriented principles of our domestic economic program. Increasing the productivity of the economy is essential. Open trade promotes this productivity improvement by augmenting the discipline imposed by domestic competition on U.S. producers with the discipline of competition from producers around the world. The effect of this competition is to promote both the efficient allocation of resources, and their efficient utilization in production. Thus, the consequence of an open international trading system is to promote productivity improvement and enhance the value of this country's output. Both are indispensable goals of this Administration.

You are probably familiar with the growing foreign complaints about U.S. policy in two areas -- interest rates and exchange rates -- that I believe well illustrate this need for focus on the fundamentals. Let me outline the Administration's views on these briefly, and then turn to three other areas of particular concern to the Treasury Department -- export credit subsidies, international investment flows, and international banking and financial services.

Interest Rates and Exchange Rates

There is a widely expressed concern abroad that U.S. domestic economic policies -- principally through their impact on exchange rates -- are forcing other countries to tighten up excessively, with harmful effects on growth and employment. The analysis underlying these concerns runs roughly as follows:

-- The U.S. is running a high interest rate policy to squeeze out inflation.

-- That policy not only is going to depress investment and growth in the U.S., but it also attracts massive flows of money to the U.S., strengthening the dollar and depressing major foreign currencies.

-- This, in turn, increases inflationary pressures abroad -- their import prices go up -- and forces them into tighter domestic policies -- to defend their currencies -- than they need for domestic purposes.

The proposed remedy is either one or some combination of the following: the U.S. should tighten fiscal policy, or should intervene in the exchange markets to dampen the pressures and insulate foreign economies from these effects.

I want to say at the outset that the Reagan Administration designed its program with foreign concerns in mind. We are aware not only of the disastrous effects of inflation on American citizens, but also of the effects on world economic and financial stability. The insistent pleas of our friends abroad to bring U.S. inflation under control have been clear and unmistakable. Our policies involve no "neglect" -- benign or malign -- as we are beginning to hear from some quarters.

In addition, I think there is a widespread misunderstanding abroad -- which to some extent may be purposeful -- both about the intent of U.S. policy and about the pressures that foreign countries are feeling.

-- First, we are not pursuing a high interest rate policy and are not using interest rates as a tool of monetary control. High interest rates are extremely damaging to our economy, as to others. They are a product of inflation and inflation expectations. When we get money growth, inflation and expectations under control, interest rates will come down. This is our objective.

-- A change in Fed policy to pump in money in response to immediate pressures would be disastrous. What is required is sustained policy -- predictability -- to ease inflation expectations.

-- Second, the idea that high U.S. interest rates are the key source of exchange market pressures abroad is either a failure of analysis or a smokescreen. Interest rates are, of course, a factor and may be particularly important at times. But: .

- o There is no very good correlation between relative interest rate movements and exchange rate movements for most major countries in recent months.
- o And there are plenty of other reasons for those movements: improving U.S. inflation performance relative to other countries; a strong U.S. balance of payments, in contrast to large deficits abroad; political stability in the United States coupled with major uncertainties in Eastern Europe and the Middle East; and, I believe, a growing confidence in the determination of this country to solve its economic problems, coupled with growing doubts about some others.

-- In short, the idea that the recent strength of the dollar is a response mainly to U.S. interest rates is wrong. It reflects much more basic trends.

-- Third, proposals that the U.S. should further tighten fiscal policy or intervene on the exchange markets are not realistic or acceptable.

- o In terms of total government deficits as a proportion of GNP, U.S. fiscal policy is the tightest of all the major countries and getting tighter. Our proposed tax cuts are essential to stimulate the flow of savings -- which will reduce the pressure of continuing deficits on financial markets -- and investment. The

Federal sector, and the Federal deficit, are coming under tight control.

- U.S. intervention to hold exchange rates, which is the essence of proposals that are being advanced by some of our foreign colleagues, is neither sensible nor practical. The markets reflect judgements by many people about a wide array of factors, some of which I have just mentioned. There is little, if any, reason to feel that a relatively few officials in governments know better where exchange rates should be than a large number of decision-makers in the market. There is less reason to feel that governments should or can try to hold rates against a basic market sentiment. Furthermore, intervention to buy foreign currencies to support exchange rates would require a massive outpouring of dollars for their purchase. This would greatly exacerbate our problems of bringing the money supply under control.
- We have adopted a policy of minimal intervention, in the sense that we are not intervening on the substantial and routine basis of the last years of the Carter Administration. Our policy is directed to the fundamentals. By bringing the domestic economy under control, we will also contribute to the longer term stability of the dollar in exchange markets. Nevertheless, if unforeseen developments trigger disorderly conditions in the exchange markets, we stand ready to intervene.

These broad policy issues are central to us and to the world economy at large. They will unquestionably be discussed at the economic summit in Ottawa later this month. Our effort will be to explain the rationale of our general approach and to persuade our colleagues of our determination to stick with our policy out of concern not only for ourselves but for them.

Let me turn now to several other issues of major continuing interest to the Treasury.

Export Credits

For the last three years, the United States and most of our industrial trading partners have been seeking to modify the OECD's International Arrangement on Export Credits, which sets guidelines as to interest rate, term and down payment for official export credit programs. The Arrangement's minimum interest rates have not been changed significantly since it was created five years ago; and as market interest rates have risen in the meantime, the extent of credit subsidization permitted under the Arrangement has also risen. The OECD estimated these subsidies cost industrial countries $5.5 billion in FY 1980.

The United States is determined to reduce and if possible eliminate these subsidies. They distort trade flows and cause a misallocation of resources. In economic terms, they represent a transfer of money from taxpayers to the subsidized export industry, the foreign purchaser, or both. In our view, it is not the business of governments to transfer income from one group of citizens to another (here or abroad) in order to stimulate trade at artificially low prices.

It needs to be understood that export credit subsidies can never provide a permanent advantage that increases domestic employment. In time they will likely be swamped by exchange rate movements. Even a project-by-project or sectoral advantage is unlikely, given that most industrial countries are providing competing export credit subsidies. To a large degree, the only predictable result is a budgetary drain for the subsidizing countries.

The negotiations on export credits consequently have a very high priority for us. Our objective is simple: we wish to align the International Arrangement on Export Credits' minimum interest rates with financial market rates in individual currencies and provide a mechanism for adjustment as market rates change.

To complement the OECD negotiations on this subject, we are giving it very high priority in other multilateral discussions and in bilateral dealings with other parties to the negotiations. Deputy Secretary McNamar visited London, Paris and Bonn early in this Administration, specifically to underline the importance we attach to these negotiations. Ambassador Brock and Secretary Baldrige made this a high priority topic on their recent European trips. And Secretary Regan has personally stressed the importance of the issue in meetings with my foreign counterparts.

We are endeavoring to ensure, through periodic consultations, that our negotiating efforts benefit fully from the advice and support of the Congress and American industry. And we hope to be able to report to you significant progress as the year unfolds.

Effective use of the United States Export-Import Bank is obviously a key way of lending strength to our negotiating position. Direct loan resources of $4.4 billion for the Bank in FY 1982 are very substantial and should be enough, with skillful management and in combination with the Bank's guarantee authority, to permit it selectively to match subsidized foreign offers. The Bank also is extending the terms of its loans beyond the Arrangement limits to take advantage of the greater breadth and depth of our financial market. We expect to target the Bank's efforts particularly against predatory financing practices by those who have been unwilling to permit improvements in the International Arrangement, until we can secure multilateral agreement to reduce or eliminate these wasteful credit subsidies.

In addition to "meeting the competition", a second function of Eximbank is very important. Although we expect U.S. private financial markets to provide the great bulk of export financing, we do recognize that there are instances in which private markets may fail to offer adequate financing for reasonable export transactions, due to such factors as unfamiliarity with the particular foreign market involved or the large amount and long terms required for a particular credit. This does not mean that the Bank should stand ready to finance borrowers that other lenders consider uncreditworthy, but that it should be prepared to act where there is insufficient private financing for worthwhile borrowers.

We were disappointed -- though not surprised -- that the May round of these negotiations produced no improvement in the unacceptable offers some of our negotiating partners made last

December. Primarily at U.S. initiative, the OECD Ministers at their meeting last month agreed that all participants in these talks "should meet at whatever level necessary to reach decisions before the end of the year." We are exploring privately with the other major countries how the impasse might be broken, and hope to be able to show significant movement by the next formal negotiating session in October.

Investment

Another issue of major Treasury interest is U.S. international investment policy. In recognition of its importance, we have recently established a working group under the Cabinet Council of Economic Affairs (CCEA), which I chair, to review U.S. policies in this area. We begin this review, the first comprehensive review since 1977, with a basic attitude that unfettered markets result in the most efficient allocation of resources and the greatest benefit to the U.S. economy. The traditional U.S. policy of welcoming foreign investments in the U.S. has provided jobs for our citizens, a wider range of goods and services for our consumers, and new technology and management techniques for our firms that enliven the economy and improve our productivity.

It is clear that international investment is integral to our overall domestic economic policy, to current and future U.S. trade patterns, and to the strength of the dollar. While the President's economic program is designed to increase the supply of savings available domestically for productive investment in our economy, we should also recognize that there is a huge pool of capital available abroad which can complement domestic investments.

We fully expect that implementation of the President's program will promote foreign investment in our economy. Passage of the President's budget and tax policies will convince foreign investors that the United States is determined to reduce the size of government, releasing a larger share of real resources to the private sector. Enactment of the President's economic program will signal clearly that we possess the political will to control inflation, a particularly important factor to foreign investors concerned about the stability of the dollar. The planned reduction in unnecessary regulation will reduce costs for all investors. In sum, we have a program with great appeal to investors, foreign and domestic alike.

We are confident that a revitalized and growing U.S. economy -- with the largest, most homogeneous market in the world, a sophisticated and extensive infrastructure and distribution system, a substantial resource base, a sophisticated and accessible capital market, and a large pool of skilled labor -- will prove quite attractive to foreign investors.

A dynamic American economy and a strong and stable dollar will also attract investment by foreigners in stocks and bonds issued by American businesses. This inflow of funds helps strengthen our capital markets, benefitting all who hold American securities. Moreover, it reduces the cost of raising both debt and equity capital, making it cheaper for firms to expand investment, which is vital to the success of the President's economic plan.

One question about which I am particularly concerned and which the Cabinet Council will be reviewing relates to restrictions foreign governments place on the freedom of their citizens to invest in the United States. Such regulations interfere with the free flow of capital and the most efficient allocation of global resources.

Turning to the other half of the investment picture, we are very much aware of the importance of our investments abroad to the U.S. economy and to the strength of the dollar. In 1980, for example, U.S. net private investment income on assets abroad totalled $42.7 billion, more than offsetting our merchandise trade deficit of $25.3 billion. In addition, U.S. direct investments abroad are a significant base for U.S. trade and a major source of U.S. corporate earnings and savings for the U.S. economy.

The Cabinet Council review will examine various forms of U.S. restrictions which unnecessarily hamper U.S. corporations' activities overseas, and in the process reduce U.S. exports. A reduction of the tax burden on Americans working abroad and a modification of some of the restrictions placed on U.S. business by the Foreign Corrupt Practices Act, for example, could lead to increased levels of U.S. investment and exports.

The review will also attach a high priority to the study of restrictions placed by foreign governments on investments by U.S. businesses abroad, and on appropriate U.S. responses. Investment incentives and performance requirements are particularly pernicious measures, through which countries attempt to tilt the economic benefits of individual investments in their favor. These measures distort both capital and trade flows, and have become increasingly burdensome to the operation of multinational corporations, and in particular U.S. firms. In our opinion, these types of restrictions also have a significant adverse affect on the countries imposing them. This Administration has expressed its concerns about these practices strongly in multilateral fora such as the OECD and the GATT, and in various bilateral consultations. Recently, the U.S. proposed that the OECD review measures of this type as a key issue on the international trade agenda for the 1980's.

Banking and Financial Services

Another issue of major interest to the Treasury Department is the U.S. effort to increase international awareness of present barriers to trade in services and to develop a consensus for action to reduce them. Treasury has participated actively in interagency discussion of the strategy which the United States might pursue in seeking to reduce barriers of particular concern to U.S. firms, and has the lead in developing a strategy for banking and related financial services.

The Treasury has been working for several years to improve the conditions under which American banks operate in foreign countries. Consistent with the U.S. policy of "national treatment" for foreign banks, enunciated in the International Banking Act of 1978, our objective has been to secure equality of competitive opportunity for American banks in foreign countries. In 1979, the Treasury transmitted to Congress a comprehensive study entitled Foreign Government Treatment of U.S. Commercial Banking Organizations. This study concluded that American banks are generally able to operate effectively and profitably in most major markets of interest to them abroad. It did, however, identify a few countries where government restrictions prevent American banks from competing on equal terms. The U.S. government has encouraged these countries to liberalize the conditions under which they allow foreign banks to operate.

Both in international organizations such as the OECD and through bilateral discussions, the U.S. government has been working with the handful of major countries that do not allow U.S. banks to compete on an equal basis to persuade them to liberalize their regulations. Although we are not yet satisfied and will continue to watch developments closely, we are pleased with the progress that has been achieved in several areas:

o Australia is reviewing its long-standing ban on foreign banks establishing offices providing the full range of banking services, with the first real chance in a number of years that American banks will be able to participate directly in that country's economic growth.

o A similar restriction was recently repealed in Canada, and U.S. banks will soon be operating there on a more equal footing with domestic banks.

o In Japan, a gradual liberalization of the financial system has resulted in U.S. banks being able to open new branch offices and to have greatly improved access to local sources of finance.

The trend towards more liberal treatment of foreign banks in such major industrial countries reflects the benefits accruing to the countries concerned, the banking community, and its customers through increased competition, new technology, and access to a wider range of banking services. Moreover, foreign governments are mindful that they cannot maintain restrictive banking environments at home without endangering free and open financial markets internationally.

In addition to the major industrial countries, developing countries represent an increasingly attractive market for U.S. banks, and the U.S. encourages them to remove restrictions on the ability of American banks to compete for local business. In some cases, progress towards more open financial markets is frustratingly slow; in others, foreign governments have recognized the advantages of developing a modern and sophisticated financial sector and have encouraged the entry of American banks. Restrictions on the activity of U.S. banks are, on the whole, more severe in developing countries than in developed countries, and we recognize the need for increased attention to developing country financial markets.

In addition to participation in banking markets in foreign countries where access is permitted, U.S. banks abroad conduct a wide range of international activities via the Eurocurrency market. These activities are conducted out of certain financial centers and do not require a physical presence within the country with which the transaction occurs. This market, together with traditional foreign banking transactions by national banking systems, constitutes a highly developed international banking network which ensures the availability of finance for creditworthy transactions.

The Eurocurrency market itself provides some export financing, but plays a broader role as a link between national financial markets and as a channel for movements of funds from surplus to deficit countries. Vast amounts of funds are deposited, traded among banks and lent to corporations and official borrowers -- essentially free of many of the costs that characterize domestic transactions, but still subject to prudential oversight. This activity is concentrated in a few financial centers, and is carried out mainly in U.S. dollars. The International Banking Facilities, which banks will be able to establish in the U.S. later this year, will bring to the United States a number of the features of the Eurocurrency market.

The international banking market has performed the bulk of the "recycling" of the large OPEC surpluses, enabling oil importing countries to finance imports of oil and other products, thereby reducing the potential strain on official financing mechanisms such as the International Monetary Fund. Banks have struck a good balance between satisfying the needs of the international monetary system and the principles of prudent banking. Indeed, these objectives are not incompatible. Creditworthy countries -- those which have demonstrated the willingness and ability to adjust their economies, if necessary, in order to achieve a sustainable external balance -- have been welcome customers of banks.

For some, the magnitude and rapid rate of growth of international banking transactions, and of the Eurocurrency market in particular, have over recent years been the focus of various concerns. A review of these concerns by the central banks of the major countries was completed over a year ago. Its principal conclusion was that they should maintain close surveillance of trends and new developments but did not see a need to adopt measures to restrain the market. That conclusion is consistent with the policy of this Administration that wherever possible free market forces should be allowed to allocate resources.

We are also interested in foreign treatment of non-bank financial services. Insurance is a particularly important sector. Here, in contrast to banking, it is more essential to have a physical presence in a country in order to transact business with its residents. But while there are legitimate regulatory interests, narrower protectionist motives often seem to be responsible for impeding the operations abroad of U.S. insurers. The OECD countries are committed to liberalize their treatment of foreign insurers, but progress has been stalled for a number of years. An effort is underway, with our strong support, to clarify present regulations and to renew the commitment to liberal treatment.

We are still reviewing the best manner in which efforts to liberalize financial services of all types -- banking, securities, insurance -- could fit into an overall approach on services -- whether through bilateral discussions or possibly through the longer-term development of internationally agreed principles with respect to trade in services. Our internal deliberations are necessarily at an early stage, but I can assure you that our objectives in any future international approach on financial services -- whether undertaken separately or as part of a broader negotiation -- will reflect Congressional interest in assuring national treatment for U.S. financial interests overseas.

Conclusion

The Secretary of the Treasury, as the Administration's chief economic official and Chairman of the Cabinet Council on Economic Affairs, which is the channel for policy recommendations on economic policy to the President, maintains an active involvement in U.S. trade policy. This is essential to fulfilling Treasury's responsibilities regarding the U.S. economy, the U.S. balance of payments, international monetary matters, and tax policy. It is also vital to insure that our domestic and international economic policies are consistent and mutually supportive.

Treasury has a keen interest in the areas of export finance, investment, and financial services which I have addressed in my remarks today. They will be important items on our agenda for the 1980s, as we seek to improve international cooperation and to reduce government impediments to the free play of market forces.

Millers' National Federation
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Statement of
Millers' National Federation
Submitted to
Senate Finance Subcommittee
on International Trade
and
Senate Banking Subcommittee
on International Finance

(Oversight Hearing on U.S. Trade Policy,
July 8, 1981)

The Millers' National Federation is the trade association of the U.S. wheat and rye flour milling industry. Our members own and operate 133 mills in 36 states and Puerto Rico. Collectively the Federation represents more than three-fourths of this country's commercial flour milling capacity.

The Federation speaks on behalf of its members on matters of general industry concern--including trade policy. In addition, the Federation's staff coordinates the organization's Export Committee activities which involve market access, development and maintenance projects.

Under an agreement with USDA's Foreign Agricultural Service, the Federation maintains a limited market development cooperator program. The overall cooperator program is one of this nation's most effective tools for developing and maintaining U.S. agricultural commodity markets.

The Federation welcomes the opportunity to address the importance of a comprehensive U.S. trade policy. In particular, we will focus on how certain aspects of this trade policy impact the maintenance and growth of agricultural exports, including processed products such as wheat flour.

At the outset, we should note that more than 70% of total U.S. flour exports move under PL 480. Though commercial markets exist, unfair export subsidization practices by the European Economic Community have shut us out of most foreign flour markets. The U.S. milling industry's frustrating attempt to gain fair access to existing world flour markets will be discussed throughout this statement.

COMMITMENT TO EXPAND AGRICULTURAL EXPORTS

The cornerstone of this Administration's agricultural policy is to expand U.S. agricultural commodity exports -- both raw and processed products. The Miller's National

Federation supports this commitment and urges the Administration to strengthen the appropriate marketing tools necessary to attain this objective.

Certain marketing tools now exist. First, there are the international trade agreements such as those that came out of the Multilateral Trade Negotiations, which allow the U.S. to seek the elimination of unfair trade practices. Such practices now hinder the increase of certain U.S. commodity exports. Second, the U.S. has a highly-praised market development agency, the Foreign Agricultural Service. FAS has capable personnel here and abroad to gather data and analyze potential markets for individual U.S. agricultural commodities. FAS also administers a joint industry/government cooperator program under which individual cooperator organizations carry out market development projects in targeted growth markets. Third, the United States has concessional financing and credit guarantee programs to make a certain volume of U.S. agricultural commodities more attractive to new and traditional customers.

The effectiveness of each of these marketing tools is often dependent upon the strength of the other two. Right now this nation's export market development system contains two very weak links. One involves the limited availability of attractive export financing. The other is the failure of our government, particularly the Executive Branch, to deal effectively with unfair trade practices.

Regarding export financing, the programs now available -- Title I PL 480 and the GSM 102 credit guarantees -- are lending themselves well to the expansion of export markets. The growth markets for U.S. agricultural exports call for greater credit availability. The Administration will have to deal with this fact and the resulting budgetary implications if it is to meet its objective of expanded exports.

According to the International Wheat Council, over 50 percent of world wheat and flour exports will be purchased by developing countries. Most of these countries have balance of payments problems and limited foreign exchange. They are shopping for credit terms as much as they are for the commodity itself. Thus, one of the key marketing tools necessary over the next decade will be attractive export credit terms and more concessional financing.

Most of our foreign competitors have ongoing credit programs for their customers. A country such as France not only provides an export subsidy on its wheat and flour exports but also offers very attractive credit terms on top of these subsidies. One such French program, COFACE, allows two year credit at 7 percent interest. And that is on top of the price cutting subsidy offered to French exporters! Further, freight rates are also subsidized at certain times.

U.S. commodities, especially wheat and flour, are finding it more and more difficult to capture a fair share of the growing markets in developing countries. This year's EC wheat surplus--which the EC will move with whatever subsidy is required--will continue to aggravate the competitive disadvantage of unsubsidized U.S. wheat and flour in the world market.

EXISTING U.S. FINANCING PROGRAMS

As you know, the United States has two financing programs available to export customers. A review of demand for the GSM 102 credit guarantees and P.L. 480 funds would ultimately show that there is not now enough attractive financing to go around.

The GSM 102 program offers U.S. customers one to three year credit at commercial interest rates. Compared to the terms offered by several of our competitors, GSM 102 terms are not that attractive.

The PL 480 program offers concessional terms to several developing countries. The problem now is that the PL 480 funding is limited and there are many countries which need much more Title I financing than is allocated. Thus they may turn to our competitors to fullfill the remainder of their needs.

One fact that this Administration must confront immediately is the transition gap between the financing terms available under GSM 102 and those under Title I PL 480. For instance, there are several Title I countries in Africa which are unable to cover all of their wheat and flour needs with the Title I funds available. A particular African country's foreign exchange may be limited and its financial status for obtaining commercial loans questionable, even with GSM 102 guarantees. What about these developing countries who are actually seeking U.S. commodities but cannot find enough financing? Do we turn them over to our competitors or do we locate or develop other financing terms appropriate for their particular financial situation?

Although the PL 480 program and the now unfunded GSM 5 program involve budget outlays, the market development benefits which accrue to this nation will more than offset the costs incurred if we do not export our agricultural commodities. This year will be a good test for the Administration as to how it will handle the tremendous volume of wheat available for export. Unless the United States comes up with some creative financing terms, we will continue to pay the price of being the residual supplier and the official food reserve keeper for the world.

The Millers' National Federation urges the increase of PL 480 Title I funding. In addition we support the implementation and financing of a revolving fund for CCC export credits.

One other export expansion tool should also be made available to wheat and wheat flour exports. The Commodity Import Program (CIP), under the management of the Agency for International Development, involves straight grants to developing nations. The funds are used for the purchase of U.S. products -- both nonagricultural and agricultural goods. Wheat and flour, because they are available under PL 480, are excluded from this export program. Countries seeking additional U.S. wheat and flour should be allowed to use their CIP funds for such purchases.

EC FLOUR EXPORT SUBSIDIES

As previously stated, more than 70% of total U.S. flour exports move under PL 480, with the majority of this volume sold under Titles I & III of the program. According to International Wheat Council statistics, there is a world market for more than 6 million tons of wheat flour. Currently the United States exports less than one million tons annually. We should have a larger share of this market but unfair trading practices by the European Community have prevented larger commercial U.S. flour export sales. For over 20 years the EC has heavily subsidized its commercial flour exports and has captured the lion's share of flour sales to third country markets. Even Jamaica, a logical U.S. flour market, imports most of its flour from Europe.

Though the industry highly values its Title I flour customers, the U.S. has additional milling capacity which could supply more commercial flour importers. The EC's highly subsidized flour exports to third country markets have been the subject of a long and frustrating case brought by U.S. wheat flour millers under Section 301 of the Trade Act of 1974. After nearly six years of high level meetings, conferences and two consultations under Article XXII of the GATT, our case remains unresolved. Until our government resolves the issue of the EC subsidies so that U.S. flour millers can compete on a fair commercial basis, the United States must depend on PL 480 to maintain its world flour market share--currently less than 20%. The EC's share, on the other hand, now exceeds 70%.

Both Secretary Block and Ambassador Brock have just returned from a series of meetings with their counterparts in several individual EC Member States, as well as with EC Commission officials in Brussels. It has been reported that both U.S. officials made it clear to the EC that the U.S. intends to compete vigorously for new markets in the grains sector and that the EC's subsidies are not acceptable if they result in a commanding share of the world market. Clearly the latter has occurred in the case of wheat flour, and a resolution of this matter is long overdue.

Congress has provided the Executive Branch with the tools to accomplish this task by ratifying the results of the Multilateral Trade Negotiations, including the new Subsidies Code, as well as by strengthening our existing domestic law, Section 301 of the Trade Act. Also, the Congress continues to provide funding for our participation in the General Agreement on Tariffs and Trade. Yet, our Executive Branch continues to be reluctant to use these tools.

After nearly six years, further "talks" or informal consultations with the EC will only succeed in further prolonging resolution of this important trade matter. Aggressive use of the formal dispute settlement mechanisms of the GATT or the Subsidies Code is needed if progress is to be made. Our participation in these international agreements and organizations is meaningless if we fail to use them for their intended purpose, namely, to ensure fair international trading rules.

We urge the Senate Finance Committee to impress upon our negotiators in the Executive Branch the need to press forward expeditioously to a forceful and effective challenge of the EC's excessive subsidies on wheat flour. It is important to our industry. It is important to an effective U.S. trade policy.

Alternatively, in order to compete with subsidized products such as the wheat flour from the European Community, a countervailing subsidy program could be developed and implemented. The Senate farm bill (S. 884) contains such a proposal.

P.L. 480 Programming

The Federation strongly recommends that additional U.S. flour be programmed under Title I PL 480. At the present time many developing countries import Title I wheat from the U.S. yet import their flour from other sources, primarily from the EC. Until the EC subsidy issue is resolved, these Title I wheat recipients should be required to take a reasonable portion of their wheat allocation in the form of flour.

This requirement would be the most logical and effective approach to maintenance and expansion of U.S. flour markets.

Currently this system is working well in the Title I Egyptian program. Egypt imports about one million tons of flour a year and the U.S supplies about 48% of this volume under Title I PL 480. Subsidized French flour comprises the remainder of Egypt's needs. The main reason the U.S. has a share of this significant flour market is that Egypt has agreed over the years to purchase at least one-third of its Title I wheat allocation in the form of flour. There are other Title I recipients which should do the same. As a result, the U.S. will benefit from the export of more added-value commodities.

ADDED-VALUE EXPORTS

We have been most pleased in recent months to hear many of our Government policymakers discussing the advantages of exporting more processed agricultural commodities. Keeping the value-adding activities within our own domestic processing sectors is beneficial to the economy. It is encouraging to know that the U.S. government is recognizing this -- yet, recognition is not enough.

Over the past several decades, the major emphasis of U.S. agricultural export policy, programs, statistical data and market intelligence has been oriented toward the basic raw commodities such as wheat, feedgrains, soybeans and cotton. The trade value of these key commodities has made a major contribution to the ever-increasing agricultural trade surplus and to decreasing the net U.S. trade deficit. Therefore efforts should continue to provide policies and programs to develop, maintain, and expand markets for these raw commodities.

However, a new dimension should be added to these fairly entrenched raw commodity export attitudes. That is, existing policy, market development tools and intelligence gathering should also incorporate the objective of increasing exports of even more of these basic commodities, but in processed form.

By exporting an added-value commodity such as flour, many segments of the U.S. economy benefit. In terms of U.S. employment and earnings, the importance of milling's contribution to the U.S. economy extends far beyond its own industry and affects jobs in many sectors, including the farming sector. In light of the Administration's ongoing effort to curb federal spending and reduce unemployment, increasing U.S.

flour exports will not only add to a positive agricultural trade balance, but also help provide jobs in flour milling, bag manufacturing, additive production, transportation and other segments of our economy. Further, added-value exports contribute to tax revenues, help our balance of payments, and help strengthen our dollar. Overall, added-value exports are in the best interest of our nation.

Our agricultural trade competitors have recognized the advantages of exporting processed commodities for many years. In fact, some even include the export of finished products such as pasta in their foreign aid programs.

RUSSIAN FLOUR IMPORTS

To support and encourage added-value exports, the Miller's National Federation has urged the Administration to include wheat flour within any new US/Soviet long term grain agreement. As you may know, the Soviets imported over 1.5 million tons of flour during the embargo. The U.S. milling industry cannot help but regret that it did not supply a portion of this Soviet flour import volume. We believe that the inclusion of U.S. wheat flour in future U.S. trade with the Soviets would be entirely consistent with a policy of encouraging expansion of agricultural exports and in particular, of increasing exports of added value, or processed commodities.

CONCLUSION

Our statement has touched on many of the market development needs for increasing U.S. agricultural exports, and in particular, U.S. flour. It is most urgent, however, that the need for more export financing be recognized and the necessary programs implemented. There are budget considerations involved. However, the Administration and the Congress have the choice of either facing the costly burden of unexported agricultural goods or of achieving the short and long term benefits of funding export programs now.

Similarly, it is most urgent that our Section 301 case be resolved now so that we can compete fairly for commercial flour markets. An effective trade policy dictates that the mechanisms provided by our domestic laws, as well as the GATT, be fully utilized in defending the trade interests of the United States. If current mechanisms prove to be ineffective in accomplishing this, then surely Congress would want to be so informed.

The Millers' National Federation again appreciates the opportunity to present our views.

Submitted by:
Wayne E. Swegle
Wayne E. Swegle
President

Statement Submitted by the
National Cotton Council of America
to the Subcommittee on International Trade
Senate Committee on Finance and the
Subcommittee on International Finance and Monetary Policy
Senate Committee on Banking, Housing, and Urban Affairs
for the Joint Oversight Hearings on U.S. Trade Policy
July 8, 1981

The National Cotton Council of America, which represents cotton producers, ginners, warehousemen, cottonseed crushers, merchants, textile manufacturers, and cooperatives, believes a high level of multilateral trade contributes to peace, is vital to the prosperity of the United States, can best be assured by the maximum use of normal private enterprise trade channels, and should be supported by a national policy to reduce and eliminate unreasonable restrictions against U.S. trade by foreign countries.

However, at the same time, the Council holds that appropriate federal action should be taken to provide reasonable restraints against imports that are disrupting, or threaten to disrupt, important sectors of our national economy. There is special need for import restraint when the domestic industry is required by the government to install expensive safety and health equipment not required of its foreign competition. The Multifiber Arrangement (MFA) and the bilateral agreements under it are examples of realistic policy. They provide for expanded trade that benefits both the exporting country and the importing country, yet at the same time, they give some order to international textile and apparel trade so that it will not unduly damage the importing country's textile and apparel industries.

A number of U.S. government officials and private citizens continue to advocate the concept of "free trade." This theory has much to offer when the trading partners are relative equals in respect to government regulations, monetary conditions, labor, capital, transportation, etc. The Common Market is an example. But when all nations are taken into consideration, this relative equality does not exist now and is not likely to exist in the future. Thus, in today's world, the possibility of "free trade" is a myth.

In the past, when communications, transportation, etc., were slower, it took longer for foreign suppliers to penetrate markets. Consequently, domestic industries had more time to adjust and take steps to preclude the development of serious repercussions from imports. But today, with the significant speed-up in communications, transportation, technology and capital transfers, etc., domestic industries frequently suffer severe impact from imports before they have time to adjust to the changing situation.

Global import data for 1979 -- the most recent available on a world basis -- reveal that:

-- 20% of the imports were by developing countries which must necessarily control their imports because of foreign exchange limitations and other reasons;

-- 45% were by the European Economic Community which controls some imports through its Common Agricultural Policy, tariffs, and other means;

-- 6% by Japan which controls many of its imports by quotas, tariffs, and other means;

-- 12% by the U.S. which controls some imports through tariffs, quotas, and other means because of domestic and national security considerations;

-- 9% by socialist countries which control imports as a part of their national economic plans; and

-- 8% by other countries (Australia, Canada, Israel, New Zealand, South Africa, etc.) which exercise some controls for various reasons.

Clearly, numerous trade policies and control mechanisms are in place which preclude a considerable portion of world trade from flowing on a free basis.

The realistic alternative to free trade appears to be liberalized trade in those cases where it would be mutually beneficial to the exporting and the importing countries under conditions acceptable to both. The U.S. cannot prudently open up its market further to imports unless there is reciprocity by a majority of its trading partners.

A multilateral agreement covering reciprocity might be satisfactory if it has specific provisions for actions against individual countries that do not honor their reciprocity commitments. This, however, would require re-definition of the status of countries currently accorded most-favored-nation treatment, an amendment to the General Agreement on Tariffs and Trade, and other actions. Otherwise, it might be necessary to provide for reciprocity on a bilateral country-by-country basis.

For economic, social, and national security reasons, the U.S. should strive to maintain economic balance among industry, agriculture, and services, as well as within these sectors. If U.S. industry became overly concentrated in the production of high technology products and we had to depend upon other countries for a significant part of our requirements for consumer goods, changing world conditions which reduced demand for high technology products or restricted our access to foreign-produced consumer goods could cause us major problems. Accordingly, it would be wise for the U.S. to follow trade policies that would assist in maintaining balanced conditions in our economy. In some cases, this might mean we should restrain imports.

We should not undermine our economy by trying to follow policies designed to prove the theory of division of labor or comparative advantage. Other countries establish policies which they consider to be in the best interest of their people, and we should do likewise without becoming unduly concerned by other countries' criticism. Such policies do not constitute protectionism. We would participate in liberalized fair trade when it served our interests to do so, but would not participate when it would cause unreasonable economic or social problems or threaten our national security. In today's world, this is the only sensible policy to follow if we want to safeguard our long-term well-being. As a sound, fundamental principle, we should not become dependent on other countries for our day-to-day needs unless it is absolutely necessary.

It is high time that some of our government officials and opinion makers realize that the international economy cannot now -- and probably can never -- operate on the idealistic concept of "free trade." As long as many sovereign nations have dissimilar economic conditions, individual nations will have to adopt policies to conform with their own special interests and needs. Consequently, there will continue to be conflicting interests at odds with a "free trade" philosophy. Our policy makers should recognize that this situation is inevitable, and they should revise our current policies and programs to protect our country's best interests in the future. The Multifiber Arrangement and its bilateral agreements demonstrate how delicate trade issues can be resolved in a manner that safeguards the interests of both exporting and importing countries on a reasonably satisfactory basis. Possibly this system could be used to resolve some of our other significant and delicate trade issues. Our goal should be to work toward more liberalized international trade on a fair and reciprocal basis without undermining or weakening our economy.

We should replace the impractical idea of "free trade" with the practical and attainable concept of "liberalized" trade. We should not let the theoretical free trade concept continue to warp our thinking in respect to trade policy.

The United Nations Conference on Trade and Development (UNCTAD) has proposed a comprehensive international agreement for cotton which would include production controls, export quotas, floor and ceiling prices, and an international buffer stock. This proposal is contrary to trade liberalization and would undermine the market-oriented U.S. farm program which has worked so successfully in recent years. The U.S. should continue to decline participation in this UNCTAD plan, which would unquestionably lead to limited U.S. cotton exports.

The Council favors a comprehensive U.S. trade policy which is flexible enough to assure that this country's best interests are realized.

In view of the increasing cost of imports, particularly petroleum products, it is evident that the U.S. must continue to expand its exports. To accomplish this objective, the Council believes efforts should be made to reduce the non-tariff trade barriers of other countries when it would increase the potential for U.S. exports of goods and services and improve our trade balance. Since services are becoming increasingly important to our balance of payments, it is vital that U.S. firms providing services get fair and equitable treatment in other countries.

The Council further believes that efforts should be made to boost export incentives. For instance, the DISC program should be expanded and improved, and tax disincentives for exports should be reduced. Specifically, the inequitable taxation of U.S. citizens who are stationed abroad by exporting organizations should be corrected.

While export credit subsidies are not considered necessary for most U.S. exports, the Council does believe the U.S. should provide export credit to countries which desire it. Such credit should be provided on a continuing basis so our foreign customers can depend upon it. Turning credit on and off like a water faucet causes problems for our foreign customers. They cannot plan ahead effectively because of the uncertainty of getting the desired credit. The U.S. should be a dependable source of supply, and our services such as export credit should be equally dependable. We believe export credit is one of the best tools the U.S. has to maintain and expand its exports of certain commodities and products.

The Council recognizes the delicate relationship between trade and foreign policy. However, we do not think it appropriate to "barter" access to U.S. markets for non-trade related goals except in cases involving national security.

Similarly, export controls and embargoes are appropriate only when our national security is threatened. When an embargo on export trade is established for reasons of national security, we believe the nation as a whole should bear the cost of the embargo and that no single sector of our economy should be unduly penalized.

Moreover, domestic economic policies could improve U.S. export competitiveness by stimulating increased productivity and reducing the occurrence of labor strikes which adversely affect our ability to export.

U.S. individuals and organizations which are adversely affected by imports should have the right to seek relief. And the most effective relief appears to be reasonable trade restraints so that imports do not reach levels which disrupt our domestic markets.

Investments should be allowed to flow freely between countries, and, accordingly, U.S. firms should be permitted to invest freely outside the U.S. unless such action would jeopardize our national security. However, we should insist upon reciprocity before granting firms in any other country investment access in the U.S.

The Council appreciates the opportunity of submitting this statement.

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NEEDED: A FREE-TRADE STRATEGY, NOT JUST A FREE-TRADE STANCE

A statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to joint oversight hearings of Senate Finance and Senate Banking subcommittees concerning U.S. trade policy. July 1981.

> The U.S. Council for an Open World Economy is a private, nonprofit organization engaged in research and public education on the merits and problems of achieving an open international economic system in the overall public interest.
>
> This statement advocates a coherent free-trade strategy to secure the best possible trade-policy premise for U.S. economic advancement, and as an indispensable step toward the most far-reaching reform of the code of fair international competition. Its other proposals include early reform of the import-relief provisions of U.S. trade-policy administration.

Our country's understanding of the importance of expanding two-way international trade to its economic health and national security has come a long way since the idiotic trade policy of 1930. But progress in reducing trade barriers is erratic. Old barriers have come down, but many remain and new ones go up. With rare exceptions, other countries are no better in this regard, most of them worse. Progress toward free trade is a slippery pole, more slippery than it ought to be.

Lack of a Free-Trade Policy

Much progress has been made in building a freer world economy, but not enough progress has been made in building a free-trade strategy to complete the processs. There are also serious deficiencies in the international-trade performance of too many U.S. corporations, either in adjusting to import competition or engaging in export promotion. In fact, the shortcomings of government policy tend to induce shortcomings in business performance. If government set a firm, credible course toward an open world economy, industry would respond more impressively in market performance at home and abroad. The uncertainties in government policy breed uncertainties in business policy, with the result that the system does not operate as well as it could and should in both domestic and international trade. A national policy to open the U.S. economy to the freest flow of imports (with appropriate protection against unfair competition), and to open foreign markets to the freest flow of U.S. exports (with carefully defined exceptions in the case of access to the underdeveloped countries), would make an all-out effort at export expansion and at coping constructively with import competition the priority commitment it ought to be in the planning portfolios of U.S. producers. Notwithstanding the rhetoric about our national commitment to "freer trade," a definitive free-trade premise is not cranked into the decision-making of government and business. It is conspicuously absent, for example, from highly touted, greatly needed efforts to increase productivity and combat inflation. The government's plans in trade policy are not where its rhetoric is.

The Administration's recent White Paper on trade policy stressed the importance of open markets at home and abroad to developing a strong U.S. economy. It pledged primary reliance on market forces to facilitate adjustment to problems of dislocation. A decade ago, another President included a comparable pledge in his State of the World message to Congress: "This Administration is committed to the principles of free trade... A continued liberal trade policy is indispensable to our domestic economic health and to a successful U.S. foreign policy." Although another major round of trade negotiations was successfully concluded between 1971 and 1981, international commercial channels, even between the economically advanced countries, are clogged with a wide assortment of artificial barriers. There is no coherent, convincing strategy to remove these obstructions and prevent new ones. To cite only one area of nontariff devices, there is no assurance that measures to protect importing countries against unfair competition (for example, in measures dealing with dumping and subsidies) will not be made a minefield to undermine legitimate forms of aggressive trade promotion.

The pledged reliance on market forces sounded more like an ideological thesis than a productive view of political and policy realities, including the realities of U.S. trade legislation. This impression is supported by the statement of the Chairman of the Council of Economic Advisers in these hearings that adjustment assistance should go to individual workers, not to industries. The testimony showed no awareness of the industry assistance provided for in the trade legislation, and the other ways government can and should consider aid to ailing industries.

Fair Trade/Free Trade

Many have referred to "fair trade" as the goal to be sought, not "free trade." Others like the sound of "free trade" but not unreasonably suspect protectionist undertones in "fair trade" as the term has come to be used in many quarters. The fact is that free and truly fair international trade are inextricably essential one to the other. Fully fair trade, covering all the rules of fair international competition, will not come without the spur provided by programming fully free trade -- an initiative that would dramatize the urgency of thoroughly reforming the code of fair international competition and ensuring the fullest reciprocity. Conversely, fully free trade cannot be secured and sustained without fully fair trade. "Free and fair" international trade thus becomes a more meaningful and constructive term than its detractors recognize.

Time for a Free-Trade Strategy

The time has come for a definitive strategy to program the phasing-out of all artificial trade barriers by the industrialized countries, and closely related reform of the entire code of fair international competition. Inclusion of fair labor standards is essential. New rounds of international negotiation on such matters as service transactions, export credits and a new "safeguard" mechanism are not enough. The free-trade timetable may have to be exceptionally long for certain products, maybe to the year 2000 for some. Departures from the established timetable may occasionally be necessary to deal with unforeseen emergencies, but strict criteria should govern such deviations. The promised land of total elimination of trade distortions (even by the industrialized countries) may be indefinitely (some might say eternally) elusive. But a definitive commitment to this objective, and to the domestic policies needed to backstop it, is practical and can be made politically palatable.

The United States should make clear its readiness to negotiate a free-trade charter with as many industrialized countries as may now care to go this route, leaving the door open to those who may now be reluctant. Raising the world's sights to what needs to be done, and declaring our readiness to participate, will sooner or later energize the universal resolve to achieve this goal. Setting a timetable for removing trade barriers may in effect accelerate the timetable.

An important component of such an initiative is the need to remove barriers to our imports from the underdeveloped countries without requiring the kind of reciprocity we would expect from the industrialized countries. Some developing countries will reach reciprocity capacity much sooner than others, but in virtually all cases the Third World timetable for reciprocal free trade will be infinitely longer than for industrialized countries, actually defying definition.

The Third World dimension poses more than a moral issue -- the obligation of rich to poor. There is also a much neglected national-security issue -- the threat to world peace from festering poverty, population explosion and explosive frustration. Also, a threat to our economic well-being if we are denied access to the Third World's critical raw materials at reasonable, rational prices -- a problem likely to become more critical unless the world's North and South engage in a more constructive, more productive dialogue than has thus far occurred. This access question was given considerable attention in Congressional consideration of the Trade Act of 1974. But the need to include this matter in trade negotiations (the statute mandated such attention) has been totally neglected except for our Council's declared concern about it. The issue merits high priority in a new initiative dealing with North-South trade development.

The new relationship we should be building with the underdeveloped countries also involves a vast market opportunity for our exports. The merging trade pattern we must envisage much more clearly is more than the exchange of our high-technology exports for their raw materials and simple manufactures. The pattern for which we must plan is trade in all kinds of goods which exporters want to sell and consumers want to buy.

Programmed removal of all trade barriers impeding all imports into all industrialized countries from all sources would bring great benefits to the developing countries even in the face of stiff competition from advanced countries in certain products. The gains may be even greater than those resulting from current policies of preferential free-trade treatment, especially when one considers the substantial stimulus which the prospect of total free trade would give to the ingenuity and growth of the industrialized countries.

The United States may stand for market forces in general and for "free trade" in its trade policy. However, we need more than a stance in this policy area. We need a strategy.

Adjustment Strategy

Essential to securing and sustaining a genuinely free-trade policy is a coherent, convincing national strategy to help ensure the orderly adjustment of American industry, agriculture and labor to substantially and consistently freer world trade in an increasingly competitive and interdependent world. A credible commitment to full employment is a major ingredient. There is still no adjustment strategy capable of reassuring the many millions of Americans who have become apprehensive about America's position in a rapidly and radically changing world economy. Without such a strategy, addressing the real problems of ailing sectors of our economy through close cooperation of government and private enterprise, there is reason for deep concern over how much progress can be made in pruning the heavy thicket of trade barriers. The present concept of adjustment assistance is inadequate.

Another neglected adjustment issue is the need for government attention to the adjustment problems of businesses that may be adversely affected, not by imports, but by the government's restriction of imports. There are jobs and investments that depend on international trade as well as those that may be adversely affected by international trade. Those hurt by government decisions restricting trade are no less deserving of adjustment help than those hurt by government policies liberalizing trade.

The adjustment strategy necessary to backstop an authentic free-trade policy should be part of an overall domestic-development strategy covering urban renewal, transportation reform, improved productivity and other programs essential to solving the nation's problems at home and increasing its effectiveness in world markets. A new frontier of American economic advancement is at hand. Full appreciation of this prospect and of its potential for sound and steady economic growth would stimulate business confidence in the outlook for good returns on heavy new investments.

Reform the "Escape Clause"

One area of adjustment policy that merits immediate attention quite aside from a free-trade initiative is the "escape clause" or import relief provision of the trade legislation, and the corresponding "safeguard" mechanism of the General Agreement on Tariffs and Trade. The international community is not adequately addressing this issue. Nor is the United States.

When industries can prove they merit import relief, the only related question now decided in extending aid to the whole industry is how, how much and how long such relief should be accorded. Import relief is supposed to buy time for industry adjustment efforts, but it has never been conditioned on detailed programs to solve the real problems of these industries in the context of the total national interest. The same can be said of specific-industry Buy American requirements (e.g., on textiles and specialty metals) in defense procurement. Trade restrictions outside the framework of coherent industry-redevelopment strategies (virtually all trade restrictions are) tend to divert attention from the full range of things that ought to be done to solve the problems that inspired the quests for import controls.

If import controls are to be imposed by whatever means (including international negotiation), the American people have a right to know for what clearly defined purpose these subsidies are required. The time has come to reform the pig-in-a-poke approach that for too long has characterized the handling of import controls. Import controls should not be imposed in some vague hope that the industry will use this adjustment time for soundly based adjustment efforts. Clear delineation of such adjustment plans, with full public accountability, should be a condition, a required framework, for whatever import restriction is established. Thus, the nation that provides help to a deserving industry should insist on a positive commitment, not be satisfied with a passive expectation -- expectation that the help provided at public expense will be used productively for the public good. Trade control to buy adjustment time should be a measure of last resort, be as little as possible and be terminated as soon as possible.

Such an approach seems consistent with a liberal interpretation of the following view in the Administration's trade-policy White Paper: "It will be critical to encourage ... all governments to adopt adjustment policies which do not have trade and investment distorting effects." We should be seeking a new "safeguard" mechanism that reflects these principles. No such effort is evident.

This long overdue reform in the handling of "escape clause" cases is not in conflict with existing legislation. Section 201(b)5 of the Trade Act of 1974 (a provision whose scope has been neglected in trade-policy administration) requires assessment of the petitioning industry's effort to adjust to import competition. By implication, this calls for (at least invites) assessment of government policies materially affecting the industry's ability to adjust, and correction of any statutory or regulatory inequities found to be impairing such adjustment. Such action is an essential component of balanced adjustment assistance to a deserving industry, whether or not import restriction is also provided.

The adjustment-policy framework outlined above should be mandated explicitly by statute. However, there is much the President (with the help of the International Trade Commission and appropriate executive agencies) can do along these lines on his own initiative, as I have suggested many times in Congressional hearings.

STATEMENT BY

ARMISTEAD I. SELDEN

PRESIDENT AND GENERAL MANAGER

AMERICAN LEAGUE FOR EXPORTS AND SECURITY ASSISTANCE, INC.

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEES ON INTERNATIONAL TRADE AND ON INTERNATIONAL FINANCE AND MONETARY POLICY, WE WELCOME THIS OPPORTUNITY TO APPEAR BEFORE THIS JOINT SUBCOMMITTEE HEARING. ONE OF THE MOST IMPORTANT NEEDS OF TRADE POLICY IS TO ESTABLISH A COORDINATED, CONSISTENT OVERALL APPROACH WHICH PROMOTES U. S. EXPORTS AND ESTABLISHES OPEN AND COMPETITIVE WORLD MARKETS. JOINT HEARINGS OF COMMITTEES HAVING JURISDICTION OVER VARIOUS ASPECTS OF TRADE POLICY ARE HIGHLY COMMENDABLE IN THAT THEY CAN LEAD TO THIS OBJECTIVE.

THE AMERICAN LEAGUE FOR EXPORTS AND SECURITY ASSISTANCE, INC., IS A UNIQUE LABOR-MANAGEMENT ORGANIZATION. FOUNDED IN 1977, IT HAS AS ITS CHARTER AND PRINCIPAL GOAL THE DEVELOPMENT AND IMPLEMENTATION OF POLICIES TO ENCOURAGE AMERICAN EXPORTS. THE THIRTY-THREE CORPORATIONS, EMPLOYING OVER 800,000 WORKERS, AND THE FOUR INTERNATIONAL UNIONS, REPRESENTING 4.1 MILLION AMERICAN WORKERS, IN THE ALESA FAMILY FIRMLY BELIEVE THAT THE UNITED STATES NEEDS TO ADOPT A NATIONAL POLICY THAT ENCOURAGES THE PRODUCTION AND EXPORT OF AMERICAN-MADE GOODS AND SERVICES IF WE ARE TO ACHIEVE THE GOALS OF (1) FULL EMPLOYMENT; (2) PRICE STABILITY; AND, (3) PRESERVING THE INTEGRITY OF THE DOLLAR. WE ONLY HOPE THE CONGRESS AS A WHOLE AND THE ADMINISTRATION WILL JOIN HANDS IN UNDERSTANDING AND ADDRESSING THE CRITICAL IMPORTANCE OF EXPORTS TO OUR ECONOMY.

MOREOVER, WE FEEL THAT THE FOREIGN POLICY AND SECURITY GOALS OF OUR NATION ARE INEXTRICABLY RELATED TO BOTH A STRONG DOMESTIC ECONOMY AND TO THE ABILITY OF THE UNITED STATES TO BE A RELIABLE SUPPLIER OF NEEDED GOODS AND SERVICES TO OUR FRIENDS AND ALLIES.

IN MANY IMPORTANT RESPECTS OUR GOVERNMENT HAS BEEN AND CONTINUES TO BE THE GREATEST NON-TARIFF BARRIER FACING AMERICAN EXPORTERS.

THE GOVERNMENT OF THE UNITED STATES HAS RESTRICTED, UNILATERALLY, THE EXPORT OF U. S. GOODS AND SERVICES TO ACHIEVE:

(A) HUMAN RIGHTS GOALS
(B) ENVIRONMENTAL GOALS
(C) ANTIBRIBERY GOALS
(D) ANTIBOYCOTT GOALS
(E) ARMS CONTROL GOALS
(F) NUCLEAR PROLIFERATION GOALS
(G) "FOREIGN POLICY" GOALS

THESE ARE ALL WORTHWHILE OBJECTIVES, BUT EXPERIENCE HAS DEMONSTRATED THAT THE UNILATERAL EXPORT RESTRICTION APPROACH HAS NOT ACCOMPLISHED THESE OBJECTIVES. IN FACT IN SOME CASES, WE HAVE ACTUALLY REDUCED OUR GOVERNMENT'S ABILITY TO INFLUENCE THE INTERNAL AFFAIRS OF OTHER NATIONS BY USING THE "EXPORT STICK".

In a shrinking world of rapidly transferable technology, in which the U. S. is no longer ~~a~~ the preeminent economic power, we cannot dictate the events in the 180 nations by unilateral export restrictions.

Thus, the answer of our association to your first question is:

> The United States does not yet have a comprehensive trade policy, but it desperately needs one.

What should such a policy entail?

Simply put, such a policy in our view should entail the elimination of unnecessary disincentives to exports and their replacement by a series of positive export incentives consistent with our international agreements.

In the legislative area, we believe such a policy should include elimination of the following disincentives.

Legislative Actions -- Elimination of Disincentives

(1) Revision of the Foreign Corrupt Practices Act along the lines of the Chafee *et al* bill and the Administrations's suggestions.

(2) Elimination of current embargoes on sales of military related products to Argentina and Chile.

(3) Revision of Sections 911-913 involving the taxation on Americans working abroad (we commend the Finance Committee for recent decisions in this area).

(4) Elimination of the ceiling on commercial sales of military equipment along the lines of the Glenn-Baker amendment.

(5) Revision of overlapping, confusing, antiboycott laws and regulations.

EXECUTIVE BRANCH ACTIONS ON DISINCENTIVES

It would appear that this Administration has a much greater appreciation of the positive role of exports in our economy and international security than their predecessors. They have moved to eliminate artificial ceilings and restrictions on sales of military equipment; they have asked Congress to eliminate country embargoes and other barriers to export. They have supported the Chafee initiative to revise the Foreign Corrupt Practices Act and many members of this Committee's initiative to revise the tax treatment of Americans working abroad. Those are positive steps and we hope Congress will act favorably on implementing them.

There are many other export issues which we believe the Executive must consider on a priority basis.

(1) Strict enforcement of MTN codes and the prompt resolution of outstanding issues, including full Japanese compliance with the Government Procurement and Standards Code.

(2) Review of complicated, overlapping licensing procedures.

(3) Availability of effective embassy support for U. S. exporters.

(4) Better, more effective, coordination between State, DOD, Commerce and Treasury on issues which directly and indirectly affect U. S. exports.

Export Incentives

It should be clear by now that flexible exchange rates in a world of cartelized oil prices and structural imbalances and immobilities do not bring about equilibrium in trade. U. S. deficits over the past five years have exceeded, on a cumulative CIF basis, over $100 billion dollars. These deficits have fueled inflation at home and eroded our competitive position abroad. We have been in a vicious cycle of double digit deficits, inflation and interest rates.

IN OUR VIEW ONE OF THE KEYS TO BREAKING THIS VICIOUS CYCLE IS A POSITIVE EXPORT POLICY. AS YOU KNOW THE CONGRESSIONAL BUDGET OFFICE (CBO) HAS ESTIMATED THAT:

-- EVERY BILLION DOLLARS WORTH OF EXPORTS CREATES 40,000 TO 50,000 JOBS

-- EVERY 1 MILLION JOBS CREATES IN TAXES (CORPORATE AND INDIVIDUAL) $22 BILLION IN REVENUE TO THE U. S. TREASURY

THUS, IF THE UNITED STATES INCREASED ITS RATIO OF EXPORTS TO GNP BY 1 OR 2 PERCENTAGE POINTS, WE COULD ELIMINATE OUR TRADE DEFICITS, GAINFULLY EMPLOY ANOTHER 1.6 MILLION AMERICANS, AND GO A LONG WAY TOWARDS BALANCING THE DOMESTIC BUDGET.

CONSEQUENTLY, AMERICA NEEDS THE BENEFITS OF TRADE. IT MUST HAVE THE EXPORTS NEEDED TO SUSTAIN U. S. EMPLOYMENT AND TO PAY FOR OUR OWN IMPORTS.

YET, OUR SHARE OF WORLD EXPORTS IS DECLINING STEADILY, WHILE THAT OF OUR MAJOR COMPETITORS -- JAPAN AND GERMANY -- RISES. OVER THE LAST DECADE, THE UNITED STATES HAS BECOME MORE DEPENDENT ON TRADE WITH THE REST OF THE WORLD, BUT LESS ABLE TO COMPETE IN IT. WE NOW EXPORT TWICE AS MUCH OF OUR NATIONAL OUTPUT OF GOODS AS WE DID IN 1970, AND ONE IN SEVEN AMERICAN MANUFACTURING JOBS DEPENDS ON EXPORTS. BUT OUR SHARE OF TOTAL WORLD EXPORTS HAS FALLEN SHARPLY SINCE 1970. IN TERMS OF DOLLARS

AND JOBS, THE U. S. HAS LOST BILLIONS OF DOLLARS AND MILLIONS OF JOBS TO OVERSEAS COMPETITORS. WEST GERMANY HAS DISPLACED THE U. S. AS THE NUMBER ONE EXPORTER OF MANUFACTURED GOODS, AND JAPAN IS THE TOP EXPORTER OF MANUFACTURED GOODS TO THE LESS DEVELOPED COUNTRIES.

WITHOUT A POSITIVE EXPORT POLICY THESE TRENDS WILL CONTINUE. WE HAVE INDICATED THE NEED FOR ELIMINATING DISINCENTIVES TO EXPORTS. LET US EXAMINE BRIEFLY SOME OF THE INCENTIVES.

ON THE INCENTIVES SIDE, WE BELIEVE THE EXECUTIVE AND THE CONGRESS ARE MOVING IN THE RIGHT DIRECTION ON SOME ISSUES BUT IN THE WRONG DIRECTION ON OTHERS. WE AGREE WITH THE NEED FOR A LONG TERM, PREDICTABLE REDUCTION IN THE TAX BURDEN WHICH ENCOURAGES GREATER DOMESTIC INVESTMENT, INNOVATION, PRODUCTIVITY AND JOBS. THE SENATE FINANCE COMMITTEE BILL WILL GO A LONG WAY IN ACCOMPLISHING THESE OBJECTIVES.

HOWEVER, ON OTHER ISSUES WE ARE GOING BACKWARD. THE UNILATERAL REDUCTION IN EXIMBANK LENDING AUTHORITY IS A BACKWARD STEP. THERE IS NO CHANCE OF REACHING A MULTILATERAL AGREEMENT ON EXPORT FINANCING TERMS WHILE WE UNILATERALLY RESTRICT THE ACTIVITY OF OUR OWN BANK. WE COMMEND SENATOR HEINZ FOR HIS $1 BILLION WAR CHEST, BUT IN THE FACE OF SHARP CUTBACKS ON THE HOUSE SIDE IN LENDING CEILINGS FOR THE BANK WE WONDER IF THIS WELL INTENDED INITIATIVE WILL BE EFFECTIVE IN ACHIEVING THE MULTILATERAL AGREEMENT IT IS AIMED AT ENCOURAGING.

WE UNDERSTAND THAT THE MEMBERS OF GATT ARE PUTTING CONSIDERABLE PRESSURE ON THE ADMINISTRATION TO PHASE OUT THE DISC PROGRAM. WE DO NOT KNOW WHAT, IF ANY PRESSURE GATT IS BRINGING TO BEAR ON OTHER NATIONS' SUBSIDIES WHICH WERE ALSO FOUND TO BE IN VIOLATION OF THE GATT ARTICLES. OUR POSITION IS THAT (A) THE UNITED STATES NEEDS ~~AN~~ EXPORT TAX INCENTIVES COMPARABLE IN ~~MAGNITUDE AND~~ EFFECT ~~AS~~ TO THOSE EMPLOYED BY OTHER INDUSTRIAL TRADING NATIONS; AND, (B) UNTIL SUCH INCENTIVES ARE IN PLACE CONGRESS SHOULD *NOT* ELIMINATE THE ONE MEAGER INADEQUATE EXPORT TAX INCENTIVE IT HAS ENACTED. UNTIL WE KNOW MORE ABOUT THE ALTERNATIVES UNDER CONSIDERATION WE ARE NOT IN A POSITION TO MAKE A JUDGEMENT ON THEIR RELATIVE EFFECTIVENESS *VIS A VIS* FOREIGN SUBSIDY PRACTICES OR THE DISC.

MR. CHAIRMAN, THESE ARE THE FACTS AS WE SEE THEM. WHAT THEN SHOULD THE UNITED STATES DO. THE FIRST STEP IT SEEMS TO US IS TO ELIMINATE THE DISINCENTIVES UNDER OUR OWN LAWS AND REGULATIONS. NUMEROUS COMMISSIONS AND COMMITTEES HAVE STUDIED THEM TO DEATH. THE NATION CANNOT AFFORD MORE STUDIES ON DISINCENTIVES. IT NEEDS A CONCERTED EXECUTIVE-LEGISLATIVE ATTACK ON PULLING TOGETHER A POSITIVE EXPORT POLICY. THE SENATE EXPORT CAUCUS HAS DEVELOPED A COMPREHENSIVE BILL, BUT IT REQUIRES A COMMITMENT ON THE PART OF EACH COMMITTEE TO DO ITS SHARE TO IMPLEMENT THOSE ELEMENTS OF THE PACKAGE UNDER ITS JURISDICTION. ONCE WE GET OUR OWN HOUSE IN ORDER WE CAN NEGOTIATE WITH OTHER NATIONS ON BOTH BILATERAL AND MULTILATERAL. ISSUES. BUT WE CANNOT REALISTICALLY EXPECT T~~HEM TO RESOLVE~~ ~~Remove their~~ our export non tariff ~~barriers against our good~~ OUR ~~PROBLEMS FOR US~~ WHEN WE CANNOT ELIMINATE OUR SELF-INFLICTED NON-TARIFF BARRIERS.

There will always be issues which require negotiated solutions. Some may be handled on a bilateral basis; others through the GATT. With regard to the latter there were some issues left hanging in the Tokyo Round. These include gaps in the government procurement and standards code as well as in the subsidies and aircraft agreement. These have been identified by the various advisory groups which continue to function. We hope the President, through his able negotiator Bill Brock will begin to seek negotiated solutions to these problems. If existing codes are being violated or ignored, sanctions should be applied to the offending countries. The U. S. has sufficient laws to deal with unfair trade practices; the problem is to enforce them before the industry and its labor force are decimated.

IN SUMMARY MR. CHAIRMAN, ALESA URGES THE ADMINISTRATION WORKING IN CONCERT WITH THE COMMITTEES OF CONGRESS HAVING JURISDICTION OVER TRADE POLICY TO CONSIDER THE FORMULATION AND IMPLEMENTATION OF A POSITIVE EXPORT PROGRAM. WE BELIEVE THIS WOULD BE AN IMPORTANT ADJUNCT TO THE TAX AND BUDGETARY ISSUES WHICH HAVE BEEN WIDELY DEBATED. IN FACT WITHOUT A POSITIVE TRADE PROGRAM WE DO NOT BELIEVE THE PRIVATE SECTOR WILL BE ABLE TO RESPOND TO THE SUPPLY SIDE ECONOMICS WHICH LIE AT THE FOUNDATION OF THE PRESIDENT'S PROGRAM.

TESTIMONY

OF

GEORGE E. TAYLOR, PRESIDENT

WASHINGTON COUNCIL ON INTERNATIONAL TRADE

ON THE TRADE POLICY OF THE UNITED STATES

I. First, I wish to thank you, Mr. Chairmen, and your committees for the opportunity to present written testimony on these important questions. What I am presenting is first, an overview of U.S. trade policy and second, a concensus of the views of a representative group of members of the Washington Council on International Trade, a non-profit organization whose current chairman is George Weyerhaeuser. These views reflect the concerns of the great exporting industries of the State of Washington (aerospace, forest products, agriculture), the ports, small exporters, the banks, freight forwarders and other trade supporting enterprises. Where there are significant views differing from the consensus, they will be identified.

Let me begin by pointing out that the Legislature of the State of Washington has recently approved a trade policy for the state itself, the first, I believe, to be adopted by an individual state. This measure, which is attached to our testimony, was adopted by the House & Senate in April 1981. The House & Senate resolved that "it is the policy of this legislature of the State of Washington to encourage all segments of state government to give strong consideration to measures which will assist the development of domestic and international commerce." In the same session the Legislature authorized the establishment of a Joint Select Legislative Committee on International Trade, Tourism and Investment for primary consideration of bills dealing with international commerce. The committee is also charged with encouragement of legislation which would monitor foreign investment, promote trade missions, develop an effective computerized data bank on international trade, and plan and fund intermodal transportation facilities. This authorization is also attached. In other words, Mr. Chairmen, the State of Washington is well aware of the fact that its economy is more dependent on international trade than that of practically any other state of the union. Our per capita involvement in international trade is twice that of the national average. It is the source of 20% of our state income; it generates over 300,000 jobs (more than any single industry). Because of our deep water ports we profit from the flow-through traffic between Asia and the U.S. as a whole. Most important of all, the economy of the state is linked to the successful functioning of a fair and open international trade system. Hence our urgent interest in trade policy.

We shall begin with the objectives of a trade policy and then with the means by which such a policy can be achieved. It is with specific policy implementation, answering the questions raised in the Committees' statement of May 27th, that most of our Council's written comments deal. But as means cannot be separated from ends except for purposes of analysis, the answers to the Committees' questions actually imply objectives when dealing with implementation.

Does the United States have or need a comprehensive trade policy?

Practically everyone engaged in international trade feels very strongly that the U.S. needs a comprehensive trade policy. Those who say that we do not now have one realize that there is not a trade policy vacuum; what they are actually suggesting is that there is not a "comprehensive" policy. What is meant by a comprehensive trade policy? By a comprehensive policy they have in mind one that relates our trade objectives (such as a strong export drive) to foreign policy, to domestic economic policy and to education. There is a strong feeling that trade policy should be given a much higher priority than it now has, that foreign policy should promote, not exploit it (except for urgent national security reasons), that domestic economic policies should be designed to promote rather than hinder and that the educational system should both inform and instruct our citizens in the economic realities of the world today. It is pointed out that you cannot have a strong commitment to an export drive if the citizenry believes in protectionism or isolationism and has little comprehension of the degree to which countries are economically interdependent, or if the disincentives to exporting are greater than the incentives, or if the U.S. imposes unilateral economic sanctions on other countries. In other words, comprehensiveness, long range commitment and integrated implementation lie at the heart of the problem. The right hand must know what the left hand is doing.

Let us briefly illustrate comprehensiveness in action. The American republic, in its early days, provides a relevant and exciting example of a trade policy. If I may quote Samuel Eliot Morrison, the new American republic, cut off from the advantages as well as the disadvantages of the British connection, was forced to trade to live. The first act of Congress dealt with trade. The first extension of American naval power was against the Barbary pirates who interfered with a trade which was world wide and interdependent. What then was our trade policy? It was the strategy of a weak neutral, compelled by necessity to fight for survival in a mercantilist world where the seas belonged to the great naval powers and the markets to their chartered companies such as the British East India Company or the Dutch East Indies Company.

What was the strategy? The young Republic called for freedom of the seas, equality of commercial opportunity, free enterprise and respect for international law, ideas which were looked on as revolutionary in the courts of Europe. These four objectives could only be achieved by playing off one power against the other, by securing the support of sympathetic merchants in other countries, such as the Manchester School in England, by unilateral action such as the opening of Japan to international commerce, and by strengthening the U.S. Navy. During the 19th century the U.S. made considerable progress towards achieving international acceptance of these objectives largely because the strongest industrial and naval power, the U.K., came to be a champion of free trade. In the meantime the Republic not only survived, it became competitive with its Yankee traders and clipper ships. It also produced a classical analysis of the relation between commerce and naval power. Admiral Mahan's Influence of Sea Power on History, probably studied more abroad than at home, both expressed and helped to shape the commercial policy of the American Republic.

The secret of American commercial strategy lay in the integration of national purpose with domestic economic growth, with naval power and with popular sentiment. That strategy carried us up to World War II, by which time it was undermined by the protectionism and isolationism of the Thirties. When a comprehensive American trade policy was put together after World War II under the Truman administration we entered a new era, but the objectives of the young Republic were not entirely forgotten.

What then is our trade policy today? It is still useful to look at it in terms of the old objectives because most of them are still valid even if conditions have changed almost beyond recognition. Freedom of the seas, for example, is very much a live issue. What is new is that the U.S. is seeking this policy objective today through an international agreement on a Law of the Sea. One of the main reasons for the Law of the Sea Conference is to guarantee the right of innocent passage through all the straits and archipelagoes of the world. But this necessary condition of free trade is now linked to a concept of the freedom of the seas that revolves around the ownership and exploitation of the resources of the oceans. U.S. policy to date has been to negotiate a Law of the Sea treaty on the assumption, advanced by Third World countries, that all countries have a claim to ocean resources outside the limits set by the coastal states. Such a revolutionary concept, at least for the U.S., raises the question as to whether the traditional American view of freedom of the seas can absorb the concept of a "global commons." Most are agreed that there must be some sort of treaty regulating the oceans but how far the U.S. is willing to compromise with Third World views is not clear. Clarification is urgent.

Freedom of the seas, in the old sense of the term, is very important but whether or not it can or should be separated from the issue of exploitation of ocean resources is not resolved. That most of the countries of the world, including the Soviet Union, are willing to accept the Law of the Sea treaty as drafted by the end of 1980 is not to be taken lightly. So long as this issue is not resolved one important plank in our trade policy will be missing.

Equality of commercial opportunity is still a live objective of trade policy but conditions have changed almost beyond recognition. Today we would say economic rather than commercial opportunity, to include investing and production as well as commerce. The intensification of international economic interdependence has forced U.S. trade policy into areas which would have been unthinkable before World War II. It is now our policy objective to provide for equality of economic opportunity through international negotiation and international institutions. We might say that the U.S. commitment to the General Agreement on Tariffs and Trade which began in 1947 is the most visible aspect of U.S. trade policy. It has actually stimulated a broadening of U.S. policy objectives to include a code of conduct in commercial and financial relations which implies, if it cannot enforce, a high degree of international cooperation, as does the effort to secure an international agreement on export financing. Put in current terminology the main plank in trade policy is the maintenance of a fair and open international trading system.

In the early days the objective was to break down the barriers put in the way of private American trading houses by chartered monopolies such as the British East India Company and the Dutch East Indies Company. Now the U.S. seeks to preserve free enterprise in a world where much of the commerce and export finance is handled by state monopolies such as those of the Soviet Union and the Peoples Republic of China and most of the Third World countries.

These monopolies are more powerful and efficient even than the old mercantilist states. But the U.S. is no longer alone as it was in the early days. Most of the world's economic strength is in the hands of the industrial democracies. They have reached a unique measure of agreement on international trading practices but most American exporters feel that even among them there is a long way to go before trading conditions are equitable. In other words the old question is still with us - how can the private sector survive in a hostile world? If there is a lesson to be learned from early American history it is that a trade policy must be comprehensive, long range and aggressively implemented to be successful. The situation is not unlike that 200 years ago; the actors and the scene have changed. Once more, what could formerly be achieved only through national power is now sought through international negotiation, at least among the industrial democracies. The thrust of U.S. trade policy is to compensate American private enterprise in competition with foreign state subsidized corporations. The promotion of free enterprise is still a very lively objective, one on which our later comments will show there is a good deal of interest.

II. Summary

U.S. trade objectives must be distinguished from the policies designed to achieve them.

A. The U.S. has several important trade objectives, some of them of long standing.

1. Maintenance of a fair and open international trading system:

The traditional "equality of commercial opportunity," the revolutionary post World War II approach, is international. The General Agreement on Tariffs and Trade (G.A.T.T.) includes the industrial democracies and some of the Third World countries. There are also other approaches such as Orderly Marketing Agreements, voluntary restraints, Trigger prices and other arrangements. The main comment from the private sector is that there is insufficient government support for the "fair" trade element in the objective.

2. Freedom of the seas:

The traditional "freedom of the seas" now includes access to ocean resources from fish to nuggets. The U.S. has cooperated through the United Nations with most of the countries of the world in a decade of negotiations for a treaty defining every aspect of the oceans, from innocent passage to the exploitation of mineral resources. There is some division of opinion in the U.S. on the Law of the Sea treaty as presently drafted, but not on freedom of the seas as an objective. An orderly arrangement for the oceans and their resources is of great importance to trade.

3. The expansion of U.S. exports:

The expansion of trade as such, vital to the young American republic, is once again an essential objective for national survival as a great power. Contemporary concentration on increasing exports is to compensate for heavy importation of oil products, to deal with the intensification of international competition due to the world wide circulation of technology and the rise of new and successful trading nations, as well as to handle some specific problems of the U.S. economy.

B. The U.S. trade policies are neither sufficiently comprehensive nor successfully integrated in implementation.
    1. Trade policies are not given a sufficiently high priority in view of the economic realities of the present day U.S. economic position.
    2. There is insufficient coordination of trade policy with domestic economic policy, foreign policy and public education. The problem is a conceptual one.
    3. Some of the difficulties in the way of coordination arise from serious differences on the Law of the Sea negotiations, on the role of the Third World, on the trade relations of the industrial democracies and on East-West trade. Very significant, perhaps, are competing views on the role of government in the economy at home and abroad.

C. Comments from members of WCIT
    1. One U.S. objective should be to increase exports rather than limit imports. There is agreement on the main policies by which this objective is to be achieved:
        a) There must be a strengthening of the domestic economy and a removal of disincentives to export.
        b) There should be government support for U.S. exporters in instances where they are faced with government subsidized

foreign competition. The U.S. government should seek international agreements to reduce or eliminate subsidization of exports. Not all companies need U.S. assistance, but none objects to this position as stated by T.A. Wilson with respect to Boeing. (See I. C.)

c) The U.S. government should be increasingly aggressive in the use of economic measures to open up markets for U.S. exports and ensure "fair" competition when the markets are "opened."

2. One objective should be to divorce trade considerations from foreign policy whenever practical. Commerce should very rarely be used to achieve the ends of diplomacy.
3. Support should be given for export competitiveness, but not for import relief. The group commented favorably on DISC arrangements, Webb-Pomerene associations and Export Trading Companies.
4. Export of capital and services abroad, direct and reverse investments, and technology trades all enhance trade to the advantage of everyone.

III. Comments from WCIT members

A. How does/should a comprehensive trade policy relate to increasing U.S. exports of goods and services through improved access to foreign markets?

1. "Government to government negotiations should continue with the goal of eliminating barriers (both tariff and non-tariff) to foreign markets. Some barriers include exclusion of U.S. manufacturers from competitive bidding, unfavorable visa status for U.S. company representatives, and unfavorable tax treatment by host governments.
   Government sponsored incentives (via grants, tax write-offs) to encourage non-exporters to make on-site market surveys, feasibility studies, etc., might be considered.
   Government to government negotiations should be instituted with objective of eliminating all 'flag carrier' requirements on trade shipments."
   William Whitaker, First Interstate Bank

2. "In our field (confectionery), it's very discouraging to be denied access to a great many markets (New Zealand, Korea, etc., etc.) because those countries will not grant their citizens import licenses to import so-called luxury products. It's especially difficult for us to understand how a country such as Korea with a very good balance of trade in their favor can be 'permitted' by American trade negotiators to discriminate in this fashion."
   Fred T. Haley, Brown & Haley

3. "By all means improved access to foreign markets is mandatory. One step already in the process which should bear fruit in the future is the installation of commerce oriented individuals as commercial attaches in our embassies. Government can only do so much in this direction. I am sure there are times political influence can be exerted. It is really up to the traders and businessmen in the United States to zero in on the international markets and perhaps more efforts to educate small to middle-size businesses should be made."
   R.C. Buckingham, Seaport Shipping

4. "I recommend that we combine existing manpower and financial resources already available in other agencies and departments to form an agency specifically charged with promotion of exports. The logical individual to head the agency would be The Special Representative for Trade Negotiation along with his present staff. It would give him something to do other than simply 'negotiate' and would make him responsible for implementing policies or positions he has negotiated.
   Japan has MITI; Korea has KOTRA; and Taiwan has CETDC, all of which operate very effectively. To finance such an agency, we should impose an import duty of 0.5% or 1% on all imports.
   Such reorganization action would also provide an opportunity to get rid of some of the deadwood in our Commercial and Agricultural Attache systems - those who visualize themselves as diplomats rather than lowly 'peddlers.' There are some very effective attaches that are of great help, but there are plenty who are time serving functionaries who seem

to do nothing but shuffle papers and complain about being overworked and understaffed when one contacts them for help. In any event, they should be given specific goals and their performance strictly evaluated against their ability to help increase sales.
...it is very difficult to get cherries into Japan because of the unrealistic inspection and fumigation requirements. Japan has non-tariff barriers on citrus, apples, beef, pork, electrical equipment, which restrict equitable trade. This same situation applies in the EEC with respect to chickens... Also Japan has always required detailed inspections and certain modifications for fireign autos that Japanese dealers have found onerous and expensive..."
Rollin T. Steinmetz, Steinmetz and Associates

5. "(U.S. exports of good and services can be increased by) encouraging U.S. Foreign Commercial Officers and the U.S.D.A.'s Foreign Agricultural Service personnel to become more familiar with U.S. companies and their present and potential foreign markets, including visits to and meetings with export oriented companies prior to their assignments abroad. In addition, the U.S. must continue its efforts to ensure that our trading partners live up to their obligations under the MTN agreement."
George H. Weyerhaeuser, Weyerhaeuser Company

B. How does/should a comprehensive trade policy relate to increasing U.S. exports of goods and services through enhanced incentives and fewer disincentives to export?

1. "We should negotiate strenuously to eliminate barriers that restrict the free flow of products and services and limit access to markets. Disincentives should be removed. Without them, our U.S. businesses will need few incentives."
Michael V. Schwisow, Washington State Department of Agriculture

2. "(I suggest that we) promote legislation which would permit establishment of export trading companies exempt from anti-trust liability for American companies similar to those in existence abroad. Foreign aid should be American products instead of Federal monies through enhancement of tax credits for American exporters to increase incentives for exporting."
Alex Tyrpak, Port of Vancouver (WA)

3. "By all means enhanced incentives are a must. And when incentives are offered they shouldn't be made so difficult to become qualified that it disenchants the participants in export trade. Perhaps rather than tax deferrals, actual tax benefits could be a superior incentive. It would be so easy to police because the Shipper's Export Declaration could be the control instrument and to avoid flim-flams, if the participant imports the same product, the imports (and American goods returned) would be deducted from the incentive."
R.C. Buckingham, Seaport Shipping

4. "...suggestion for input...information on incentives available to Australian exporters...The Australian export incentives scheme provides for an export development grant in two forms: 1. a refund of 75% of expenses incurred by an exporter in establishing new export markets or in the export of his goods. These expenses are such matters as advertising, legal costs, etc.; 2. an incentive grant based upon the increase in value in real money terms of the amount exported by the exporter in any given year over a base year nominated in the export development grants act. This scheme is controversial as it is regarded as overly generous. However, it has been successful in increasing the interest in export by Australian manufacturers. This program only applies to manufactured goods."
   Christopher T. Bayley, Perkins, Coie, Stone, Olsen & Williams

5. "Eliminate income taxes for U.S. citizens resident abroad who represent U.S. business interests. Recent trends indicate that U.S. companies are hiring third country nationals to represent them. Such people tend to sell products with which they are most familiar, when given a choice - third country products - rather than U.S. goods.
   Provide specail tax incentives to exporters above and beyond DISC.
   Compete with some of our trading partners who provide, through their banking systems, subsidized low-cost pre-export financing facilities.
   Eliminate onerous U.S. government export license requirements to the maximum extent possible."
   William O. Whitaker, First Interstate Bank

6. "...the U.S. is the only major country which imposes taxes on their overseas citizens. In most cases, these additional costs, levied on expatriate workers of U.S. corporations, are paid by the employer and thus increase the cost of doing business. This 'tax equalization' policy is followed by Seafirst for its employees abroad...
   A study has been done here to determine the savings which could be realized by the corporation if it replaced its expatriate staff with foreign nationals. The savings are estimated to be just under $200,000 per year.
   ...Seafirst supports legislation to restructure the tax laws with regard to U.S. employees abroad."
   Richard A. von Boecklin, Seattle-First National Bank

7. "We recommend the tax treatment of U.S. citizens working abroad should be improved to place the U.S. in a more competitive position with tax practices of other countries."
   George H. Weyerhaeuser, Weyerhaeuser Company

C. How does/should a comprehensive trade policy relate to increasing U.S. exports of goods and services through improved access to foreign markets?

1. "To encourage small and medium-sized U.S. firms to expand into the world market-place, a more understanding and cooperative system of financing should be developed."
   Michael V. Schwisow, Washington State Department of Agriculture

2. "In the area of export financing, one issue that is difficult to overlook here in the Northwest, is that of the continuing role of the Export-Import Bank. That the bank is an important part of U.S.

trade policy and needs long-range government support and funding, was recently challenged in Congressional hearings. As you know, Eximbank ended up with austere, barely adequate funding.
Seafirst has worked closely with Eximbank not only with its guarantee programs, but also on proposals for the sale of capital goods. Although the economy of the Pacific Northwest has diversified since the 1970's, the fortunes of the Boeing company, as the nation's largest exporter of manufactured goods, still greatly affect the health of our own local marketplace. In 1981, 60% of Boeing's sales were tied to Eximbank loans, and no one who does business in the Northwest can doubt that a strong, well-funded Eximbank is crucial to our regional well-being."
Richard A. von Boecklin, Seattle-First National Bank

3. "(suggestion) Encourage the present administration to continue favorable financing by the Export-Import Bank of the U.S. which finances 70% of the export cargoes from the United States."
   Alex Tyrpak, Port of Vancouver (WA)

4. "(U.S. exports of goods and services can be increased by) continuing to provide competitive export terms, as necessary, through such organizations as the Export-Import Bank and Commodity Credit Corporation to place U.S. exporters on equal terms with their foreign competitors However, in general, we feel that export subsidies should be reduced or eliminated worldwide to stimulate free and open competition in world markets."
   George H. Weyerhaeuser, Weyerhaeuser Company

5. "Where needed, the subsidization or partial subsidization of financing and credits could help in the following areas:
   -Building of plants or facilities in the U.S.A. involved in exports.
   -Research and development, manufacture and/or production of the product for export.
   -Sales and marketing."
   R.C. Buckingham, Seaport Shipping

6. "There is a need to remain competitive with other trading nations which offer export incentives or, conversely, negotiate on a government to government basis for the multinational elimination of such subsidies altogether.
   Keep U.S. Eximbank and FCIA viable and competitive with their foreign counterparts."
   William O. Whitaker, First Interstate Bank

7. "If we really intend to reduce dependence on EXIM financing in competitive cases, we must have an enforceable international agreement. The Boeing Company would prefer to sell in the foreign market without benefit of subsidized financing, but it takes two to tango. For several years, the U.S. Government has been negotiating in the Organization for Economic Cooperation and Development (OECD) to eliminate subsidized export financing. Boeing supports this objective but we believe that the only way we can convince the governments of the EOCD to reach a meaningful agreement is to maintain a strong Export-Import Bank until such an agreement is reached. To do less than this puts U.S. exporters at a cometititve disadvantage.
   T.A. Wilson, The Boeing Company

D. How does/should a comprehensive trade policy relate to the use of trade for foreign policy purposes through the use of access to U.S. markets and/or access for U.S. exports to obtain nontrade related goals?

1. "The total removal of trade considerations from the foreign policy formulation process is probably not practical. But it should be an ideal. A smooth trade business calls for a high degree of confidence and mutual trust between the exporter and importer. If, due to government intervention, the exporter cannot perform, his business is undermined and, when the illustration is multiplied, could lead to trading partners judging the U.S. to be an unreliable trade partner."
   William O. Whitaker, First Interstate Bank

2. "...regarding the use of trade for foreign policy purposes by restricting access to U.S. markets in order to obtain political concessions, this must be a resounding no."
   Roy E. Leach, Royel Industries Intl. Inc.

3. "For years we have watched our State Department sell some segment of U.S. export business down the river to accomplish their diplomatic goals. It has been a rare case where they have had the guts to use the same tactics to accomplish U.S.A. commercial or diplomatic goals. There is no question that commerce and diplomacy have to walk hand in hand. But the sense of direction has to be adjusted because diplomacy should be used to enhance trade. The use of commerce as a diplomatic club should be used sparingly and very discreetly."
   R.C. Buckingham, Seaport Shipping

4. "To use market access, export controls, and/or embargoes to obtain nontrade goals is a dangerous game. We believe the results not to be worth the cost, unless armed conflict is involved."
   Michael V. Schwisow, Washington State Department of Agriculture

E. How does/should a comprehensive trade policy relate to the use of trade for foreign policy purposes through export controls and embargoes?

1. "Export controls and embargoes should not be used in my opinion for political purposes other than for strategic materials, even though it is very tricky as witnessed by the Israeli raid into Iraq using U.S. made aircraft in violation of their agreement when purchasing the equipment."
   Roy E. Leach, Royel Industries Intl. Inc.

2. "(U.S. exports of goods and services can be increased by) keeping both access to U.S. markets and access to export markets free of all controls, embargoes or other impediments to free trade, including any state or Federal laws which restrict the export of U.S. raw materials, manufactured products or other goods and services, except for national security reasons."
   George H. Weyerhaeuser, Weyerhaeuser Company

3. Export controls and embargoes strategically and diplomatically at times are a must, however, these policies should be used very sparingly and discreetly. We do have some very serious problems relevant to embargoes. The U.S. Anti-Boycott Law is creating an onerous work load

for the U.S. businessman and is destroying much trade and relations with some key Mid-East customers of many of our products. We make a mountain out of a molehill with the Mid-East boycott situation while at the same time ignore boycotts in other directions. First, the U.S.A. is boycotting certain countries with political or ethnic philosophies different from our own. Second, a classic example of a boycott against the U.S. has gone ignored by our diplomats. The European Economic Common Market has literally excluded many U.S. products from the U.K. and European markets. These products were moving into that trade prior to the formation of that group. Yet, we permit that group to export to the United States without penalty. We believe this entire problem could have been avoided simply by embargoing French wines or putting penalty duties on same as long as they discriminated against U.S.A. products."
R.C. Buckingham, Seaport Shipping

F. How does/should a comprehensive trade policy relate to the use of domestic economic policies that improve U.S. export competitiveness?

1. "...the maintenance of the DISC program, the encouragement of Webb-Pomerene organizations, and promotion of U.S. trading companies are domestic economic actions that are positive and should be encouraged and developed."
   Michael V. Schwisow, State of Washington Department of Agriculture

2. "Developing a policy in which all levels of government work more smoothly and efficiently in the approval and permit processes to facilitate the development of export-related facilities, including ports, transportation and other export-oriented operations. Government should also ensure that necessary environmental safeguards are reasonable and do not place U.S. industry at a competitive disadvantage in serving world markets."
   George H. Weyerhaeuser, Weyerhaeuser Company

3. "Regarding the use of domestic economic policies to improve U.S. export competitiveness, yes, this should be done as is the case of the Export Trading Company Act now being pondered."
   Roy E. Leach, Royel Industries Intl. Inc.

4. "Acceptance financing...is heavily utilized in foreign trade and as trade flow increases, it is possible to project that the U.S. banking industry could find itself unable to provide this type of financing because of present regulation...We would support current proposals to allow a limit of 200% of capital (for acceptance financing)."
   Richard von Boecklin, Seattle-First National Bank

5. "Increase the effectiveness of Federal agencies to assist and coordinate American firms for export products. Decentralize controls, increase authorities in districts, regions, areas."
   Alex Tyrpak, Port of Vancouver (WA)

6. "No comments."
   William O. Whitaker, First Interstate Bank

G. How does/should a comprehensive trade policy relate to the use of domestic economic policies that provide for import relief and adjustment?

1. "Using our economic policy to provide for import relief and adjustment is in my mind a negative thing and smacks of protectionism, which I do not like."
   Roy E. Leach, Royel Industries Intl. Inc.

2. "The answer to strengthening America's position in the world marketplace is not placing restrictions on imported goods, but equalizing tariffs."
   Alex Tyrpak, Port of Vancouver (WA)

3. "The use of domestic economic policies that (a) improve U.S. export competitive-ness, and (b) provide for import relief and adjustments -- If this concern has to do with non-tariff restrictions, quotas, and the like, that the recently directed pressure against the Japanese in the case of automobiles is the kind of argument which eventually leads to tariff walls and is certainly wrong under our system of economic beliefs."
   Fred T. Haley, Brown & Haley

4. "Domestic policies governing imports should be developed judiciously and cautiously to prevent reciprocal action that would stagnate trade."
   Michael V. Schwisow, Washington State Department of Agriculture

5. "Why?"
   R.C. Buckingham, Seaport Shipping

H. How does/should a comprehensive trade policy relate to investment and services policy opportunities and restrictions on investment by U.S. firms abroad?

1. "(U.S. exports of goods and services can be increased by enacting tax and investment policies which encourage the export of U.S. goods and services to world markets, including construction contracts, use of U.S. consultants, purchase of U.S. equipment, and application of U.S. technology."
   George H. Weyerhaeuser, Weyerhaeuser Company

2. "Aim for the ideal: quid pro quo."
   William O. Whitaker, First Interstate Bank

3. "...I do not believe there should be any restrictions on investment by U.S. firms abroad and our policy should be one of opening as many doors as possible for such investments if we wish."
   Roy E. Leach, Royel Industries Intl. Inc.

4. "Insofar as investment is concerned, we believe every chance for exchange of opportunities between countries should be developed. It seems probable that joint ventures, reverse and direct investments, technology trades, and so forth can only enhance trade growth and the closer alignment of counterpart industries to the advantage of all."
   Michael V. Schwisow, Washington State Department of Agriculture

I. How does/should a comprehensive trade policy relate to investment and services policy strategy for reducing barriers to trade in services?

1. "...yes, our service policy should include strategies for reducing barriers to trade in services as well as in goods."
   Roy E. Leach, Royel Industries Intl. Inc.

General Comments

"From my personal experience, I can say that the USA does not have a coordinated comprehensive export trade policy. We badly need one.

We should treat our trade partners the same as they treat us. If they erect non-tariff barriers we should do the same...trade is a two-way street.

Our community colleges and universities should be encouraged to teach export technology and management as a separate specialty within their export curricula of business administration. This will eventually create a corps of business persons who are export oriented and know how to go about doing it. Some of the funds generated by the import duty on all goods should be used to endow chairs and grant scholarships. This is comparable to educational programs in agriculture that are largely responsible for the most efficient and productive agricultural system in the world.

There are too many committees in the Congress who all want to get involved in export policy decisions. This causes fragmentation of effort and responsibility. The results are less than impressive."
Rollin T. Steinmetz, Steinmetz and Associates

" Does the United States have or need a comprehensive trade policy? The answer is yes, there is a need, and no, we do not have. And yes, they should consider the trade policy which will improve access to foreign markets, remove disincentives to export, and international use of export credit subsidies should certainly be considered."
Roy E. Leach, Royel Industries Intl. Inc.

"Weyerhaeuser believes that the U.S. should have a comprehensive trade policy designed to remove disincentives to exporting and expand international commerce."
George H. Weyerhaeuser, Weyerhaeuser Company

"The State Department, International Trade Administration and trade groups throughout the nation should communicate and work effectively together to eliminate trade barriers. Where a country has barriers or artificial barriers against our products it's mandatory that we get tough and give them the same treatment if they do not adjust.

Another item that would most certainly assist in the 'balance of trade' would be to establish a true incentive for the use of U.S. flag vessels in our international commerce...Perhaps some form of tax benefit rated on the U.S. flag freight payments could be the incentive."
R.C. Buckingham, Seaport Shipping

"To enhance exports requires that adequate port facilities be available, and we should support promotion of legislation which would encourage and enhance a strong, viable port system throughout the United States.

Port authorities should insist that the present administration fully

fully understand the impact proposed water use charges on deep draft vessels may have on import/export traffic before implementing this charge. Certain cargoes may definitely be forced to use other ports or gateways and may be competitively eliminated completely if water user charges are not uniformly applied at all ports.

The U.S. needs uniform tariff application."
Alex Tyrpak, Port of Vancouver (WA)

"In these days of deregulation at the Federal level, it would seem that perhaps this committee is missing the point, somehow, in trying to establish comprehensive trade policies and all of the related factors that would ensue."
Richard Dale Smith, Port of Tacoma

"I prefer starting with a 'philosophy' rather than a policy. It allows us more freedom, and better relates to hearings. Such an approach could be a better expression for agriculture, manufacturing, finance, and distribution. The expression of that philosophy should be quite simple:

1. Exports from this state as well as the country are essential.
2. Washington State philosophy adopts exporting and importing.
3. Education at all levels reflects strongly both conditions.
4. Taxes must be directed to implement those actions above.
5. If such steps are not followed, negative economic growth results.

...In developing our philosophy, we should argue that restrictions of trade will result from improperly or indirectly applied taxes on our people and their businesses. Every taxing action we take should be with the intent to improve exporting - and importing."
T. Evans Wycoff, Capital Resource Corporation/Johnny Appleseed

"International trade is so vital to our state that every effort to improve it should be made.

The United States needs a comprehensive trade policy. Many American international businesses have floundered about for years, struggling to compete with their counterparts from nations more attuned to the importance of effective international trade. They have been often handicapped by our own government.

We believe that the best long-range interests of all are served in an atmosphere of free trade...our policy should strongly encourage it."
Michael V. Schwisow, Washington Atate Department of Agriculture

"Our premise is that it is ESSENTIAL, not simply desirable, for the United States to promote its exports. Ideally export promotion would be geared to achieve a balanced global trade position recognizing that there may be country-by-country imbalances at any given time."
William O. Whitaker, First Interstate Bank

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U.S. ECONOMIC RECOVERY LIES BEYOND THE WATER'S EDGE

Slowly and painfully, America is rediscovering the vital importance of international trade and investment to its own domestic economy. This would seem almost an anomaly, given this nation's heritage of clipper ships and the time-honored American tradition of "Yankee Trader."

But the fact of the matter is that from our own industrial revolution in the late 1800s through the post-World War II period, commerce with other nations was something we took more or less for granted, except for our disastrous experimentation with protectionism at the turn of the century and again through the infamous Tariff Act of 1930. Those flirtations with the politically appealing concept of telling the rest of the world where to get off, economists and historians agree, helped fertilize the seeds of a major world economic depression sandwiched between the two world wars of this century, if in fact they were not a primary cause of all three calamities.

As a nation, we are now paying the price for those 100 years of indifference to international commerce, and we shouldn't be surprised at the cost. The bad news has moved from the back business pages of our magazines to the front pages of our newspapers and onto our TV screens -- mounting trade deficits; worker layoffs in our basic steel, automotive and textile industries; and dire forecasts of a return to Smoot-Hawley protectionism in Congress.

What has happened to America's competitiveness in the world market over the past two decades has become a favorite phenomenon for study by academe, the U.S. government, business-oriented think tanks, and thoughtful politicians.

As with most complex diagnoses, the experts don't agree on either the causes or the cures. What is more important, there is not yet a much-needed broader public recognition and understanding of where we are today, our strengths and shortcomings, and the need for a better ordering of our national priorities.

President Reagan and his trade representative, Ambassador William Brock, have begun anew a long needed effort to build public support for such a restructuring of our values as well as our economy. They need all the help they can get, because it is by no means a simple or easy task.

The plain truth is that for at least 20 years from the end of the second World War, the United States had its trade surplusses handed to it on a silver platter, without much thought or effort on the part of our own business community; before that we thought we didn't really need foreign business to grow and prosper. We still represent, for example, the largest single national market of consumers in the world, with the purchasing power to make it also the richest market; and except for certain metals and minerals and some other raw materials and consumer goods, we have not known the real meaning of import dependence.

Until the oil crisis, that is. Now we do.

But that's far from the whole story, and it is dangerously simplistic to lay America's current trade problems on the energy "crunch" alone.

In the 1980s the recovery and growth of the U.S. economy depend critically on foreign trade and investment. Moreover, because interdependence among nations in the world market has become a reality, government and private actions affecting business in one country impact equally importantly on jobs, profits, and consumers in other countries geographically remote, not the least ours.

These actions affect the binational commercial and even political and diplomatic relationships between nations. Trade in goods and services between nations can contribute mutually to employment, profits and higher standards of living; but unemployment, inflation, and economic stagnation also can be "exported" through nationalistic policies of protectionism, and unfair trade practices such as unreasonable export subsidies, cut-price "dumping" and other governmental and private interventions in the free exchange of goods and services, known as "non-tariff barriers" (NTBs) to trade.

It is this fact of increasing international economic interdependence which underlies the critical new importance of foreign trade and investment to the United States.

The statistics support this premise:

o U.S. exports, as a percentage of the Gross National Product (GNP) have doubled over the last 10 years to approximately 10 percent. While this is less than that of many other trading nations, today we export one-fifth of everything we grow or make in this country, accounting for one of every eight jobs in the manufacturing sector, and one of every three acres of agricultural production. World trade, over the past three decades has increased 10-fold in volume alone (much more than that in value), and the U.S. is still the world's largest single exporter and importer.

o U.S. non-petroleum import dependence also is rising -- for seven of ten strategic metals and minerals it now ranges from 62-98 percent -- as well as for other raw materials, semi-manufactures and consumer goods. Imports, too, account for hundreds of thousands of American jobs, as well as contributing to anti-inflationary competition and a wider range of consumer product choice.

- Yet the staggering oil-induced trade deficits that have beset this country for the past several years have masked our true competitiveness in the world market. Absent our oil import bill, we would have been registering increasing trade surplusses. When trade in services (including earnings on U.S. direct foreign investment) is factored into the overall balance of payments, our trade deficit is virtually wiped out. Even on trade-in-goods terms alone, in March of this year we registered our first monthly surplus in five years. Our trade surplus with the 10-nation European Economic Community last year ($25 billion) more than doubled our highly visible trade deficit with Japan.

In short, international business represents the leading edge of American economic recovery and growth, the economic "revitalization" we hear so much about these days.

New Focus in Washington

Given the increasing importance of international commerce to the domestic economy, the Reagan administration and the 97th Congress have raised equally the priority of policies, regulation and legislation affecting international trade and investment.

More legislation and Executive Branch actions aimed at expanding and removing disincentives to U.S. exports are currently under consideration in Washington than even during the recently concluded seventh post-World War II round ("Tokyo Round") of multilateral trade negotiations (MTN) from 1973-79.

At the same time, more consideration is being given in Washington — on the Hill if not "downtown" — to temporary import relief for impacted industries in special cases.

Also, the federal government is currently attempting to implement a major reorganization of its trade policy and negotiating functions, approved by Congress in 1979. On its part, Congress is considering still further reorganization of these functions, including the establishment of a new Department of International Trade and Investment.

In the words of U.S. Trade Representative Brock: "At no other time in our history has international trade so dominated our thinking. Trade is our nation's life-blood, and this administration clearly recognizes the imperative to compete in the world market. Not since the first U.S. tariff bill was introduced in Congress in 1789 has there been a greater need for a forward-looking comprehensive trade policy. The opportunity has never been better. I know American workers and industry are equal to the task. They will have an aggressive and eager partner in this adminstration."

The administration is considering new U.S. government policy initiatives affecting many aspects of international business in the decade ahead. These include the following:

o less burdensome taxation of income earned by corporations and employees outside the territorial limits of the United States;

o liberalized overseas application of U.S. antitrust laws;

o clarification of the Foreign Corrupt Practices Act;

o implementation of the Tokyo Round MTN codes covering subsidies and coutervailing duties, antidumping, standards, government procurement, licensing, customs valuation, trade in meat and dairy products, and civil aircraft;

o negotiation of new international codes of conduct covering trade in services, import "safeguards," counterfeiting, and agriculture;

o negotiation of an international agreement on limits to export credit financing;

o revisions of export controls;

o new East-West trade guidelines;

o increased trade with developing countries, but with a tightening of the U.S. Generalized System of (Trade) Preferences (GSP) to "graduate" more advanced developing countries from duty-free treatment;

o changes in the Trade Adjustment Assistance program;

o increased trade with Canada and Mexico, including the possibility of new bilateral trade agreements with both countries;

o extension of the international arrangement on trade in textiles and apparel (multifiber agreement -- MFA);

o provision of new export incentives such as the authorization of export trading companies with bank ownership participation; and

o removal or amelioration of existing export disincentives such as hazardous substance controls, environmental and safety regulations, and human rights policies.

What this means is that for the first time in a century, international business and America's role in it is in the public policy spotlight -- in Washington, and to a lesser but increasing extent in corporate board rooms across the nation.

U.S. Trade Policy - Whence to Whither

Basically, U.S. trade policy today has not changed direction from the 1934 "unconditional most-favored-nation" policy of then-Secretary of State Cordell Hull, enacted in the first Reciprocal Trade Agreements Program.

Essentially grounded in the concept that the freest possible trade between nations benefits each and all, it became a kind of "Golden Rule" by which international commerce was to be governed.

And from the historic Bretton Woods and other post-war economic conferences in the late 1940s -- which established among other institutions the General Agreement on Tariffs and Trade (GATT) -- through the '50s and early '60s, it worked. The U.S., Western Europe and Japan enjoyed the greatest period of economic recovery and growth in world history. Five post-war international rounds of multilateral trade negotiations (MTNs) -- six counting the Kennedy Round from 1964-67 -- reduced prohibitive rates of import customs duties, then the principal bar to freer trade, nearly to a point of insignificance.

But by the early 1960s, subtle but significant changes were beginning to take place, in the world market, and here at home. As the war-torn economies of Western Europe and Japan staged their economic "miracle" of recovery and began to become competitive again, their governments found it expedient -- as, indeed, in numerous instances did our own -- to succumb to the temptation of erecting less visible but even more effective non-tariff barriers to trade. Even by the time of the Kennedy Round, international trade negotiators attempted to find agreed multilateral constraints on such practices as cut-price dumping, and discriminatory methods of valuing imported goods for customs duty purposes. Those attempts didn't work, primarily because the U.S. Congress refused to go along with the deals its American negotiators had struck.

This reflected a subtle change that had already begun to take place at home: the growth of popular suspicion in this country that our State Department, concerned more with our political and diplomatic objectives overseas than with the national economic interests of this country, was "giving away the store" — making more trade concessions than it received in return.

In fact, the Trade Expansion Act of 1962, which authorized U.S. participation in the Kennedy Round, also transferred American negotiating authority from the State Department to a newly created Office of the Special Representative for Trade Negotiations in the White House. The intent of this move was to place American trade policy-making and negotiating on a more "even-handed" basis.

This trend was reflected in both the Trade Act of 1974, which authorized U.S. participation in the Tokyo Round of multilateral trade negotiations, and the Trade Agreements Act of 1979, which implemented the results of those negotiations.

Those landmark bills, together with the 1979 Presidential Reorganization of Trade Policy Functions, greatly strengthened both the stature and the authority of the renamed Office of the United States Trade Representative, keeping it in the Executive Office of the president and raising the position to Cabinet-level status.

By this time, the watchword in this country had shifted from "free trade" -- the rallying call of Hull trade policy -- to "freer but fairer trade."

This of course represents a recognition both that truly "free" trade is an ideal concept unattainable in the foreseeable future, and that unreasonable interventions in the marketplace by governments or private companies should not be tolerated under the guise of a liberal trade policy.

The Tokyo Round did result in a number of new, precedent-setting international accords governing the use of several non-tariff barriers. The Reagan administration recognizes this, but also the need to do more. Recently Ambassador Brock noted that our agenda calls for further negotiation to remove more of these barriers.

Another equally meaningful change that has been taking place is the trend toward bilaterally (or trilaterally) negotiated resolutions of particularly visible and irritating trade disputes through so-called "orderly marketing agreements" (OMAs) or "voluntary restraint agreements" (VRAs).

The most recent example of this sort of device, of course, is the recent settlement of the U.S.-Japanese automobile dispute. Other such approaches have been used in trade in steel, textiles and apparel, shoes, color televisions, and even mushrooms.

Doctrinaire defenders of strict adherence to the more legalistic multilateral resolution of such trade disputes are quick to label such technical diversions from international procedures as thinly disguised "protectionism." Defenders of such arrangements defend them equally stoutly as necessary poltical solutions, which if not reached in "special" cases, would permit economic irritations to fester and erupt into full-scale trade "wars," which would more certainly lead to a rash of protectionism, worldwide, across all product lines.

In a recent interview with the U.S. International Communications Agency, Ambassador Brock summed it up this way:

"Generally speaking, you want to avoid any step away from freer trade, but sometimes you take one step backwards in order to take two steps forward. The question is whether you have the commitment to take the two steps forward. We really are committed to an expanding world trading system."

Still another change that has marked the development of U.S. trade policy is a growing, and somewhat painful recognition that it is the developing world, rather than the industrialized one, that holds the markets of the future. Just last year, for example, an impressive 30 percent of American exports went to the less-developed countries, more than to any other single group of countries.

The developing countries, of course, are striving to break out of their traditional role as suppliers of raw materials and purchasers of finished goods. As they are successful in achieving their objectives, the industrialized nations will be buying more finished and semi-finished goods from them, but this trend also opens up new markets for capital goods, manufacturing equipment, even in high technology sectors, where the more advanced developed countries are gaining a competitive advantage.

The Reagan administration has placed high priority on trade with the developing countries. Ambassador Brock wrote recently:

"We must take aim at the potentially enormous Third World markets - especially those of neighboring Central and South America. There is a large pent-up demand in these countries as they seek to achieve economic, political and social progress, for an array of manufactured and high-technology goods, such as telecommunications equipment and computer technology. We must appreciate the relationship between poor communications and political isolation. Latin American markets represent a unique challenge to participate in the individual development of these nations as they strive to improve their economies and endeavor to raise their standards of living."

Wanted: A Public Response

The Reagan administration starts from perhaps the firmest economic and philosophical commitment to freer trade then any since Franklin Roosevelt's.

But American trade policy today is more than a single doctrine. It is a complex set of policies which must constantly be built upon and refined to meet the challenges of a rapidly, and often disruptively, changing world market.

In sum, our participation in international trade has become a key to our economic progress at home as well as our competitiveness in the world market.

There are enormous opportunities for American industry, agriculture, and services in that market, as well as formidable challenges. How we meet those opportunities and challenges will help determine the rate of our economic growth, employment, inflation -- in short, our standard of living -- for at least the decade of the 1980s.

But to capitalize on these opportunities, there first must be redeveloped in this land a broad, popular understanding of, and support for, the need for us to earn once again the name of "Yankee Trader." And to do that, there must be a renewed willingness by all of us -- business, labor, and consumers alike -- to participate more fully in the public policy process that helps shape national and international commercial policy and practice.

As a nation, our economic well-being, and even our security, depend on it.

John C. L. Donaldson
Vice President, International
Gray and Company
July, 1981

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IN THE LEGISLATURE
of the
STATE OF WASHINGTON

1889

CERTIFICATION OF ENROLLED

HOUSE CONCURRENT RESOLUTION NO. 4

Adopted by the House February 20, 1981
as amended

Adopted by the Senate April 9, 1981

CERTIFICATE

I, Vito T. Chiechi, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is enrolled House Concurrent Resolution No. 4 *as adopted by the House of Representatives and the Senate on the dates hereon set forth.*

Vito T. Chiechi *Chief Clerk*

ENGROSSED SENATE CONCURRENT RESOLUTION NO. 109

State of Washington
47th Legislature
1981 Regular Session

By Senators Jones, Fleming, Bottiger, Hayner and Quigg
(By Lieutenant Governor Request)

Read first time March 19, 1981, and referred to Committee on COMMERCE AND LABOR.

WHEREAS, The state of Washington is a governmental entity which can guide, direct, and influence conditions affecting international trade, tourism, and investment; and

WHEREAS, The state of Washington, by virtue of its geographic location and plentiful natural resources, has an economy which is unusually dependent on international trade and because of changing international economic conditions will have the opportunity to increase its trade; and

WHEREAS, The state of Washington has a primary interest in the assessment of the impact of international trade upon the economy of the state and to determine the appropriate role of state government in the development of a favorable climate for international trade; and

WHEREAS, Past activities of the Joint Legislative Committee on International Business and Tourism enhanced and expanded the scope and quantity of international trade with Washington business; and

WHEREAS, Emerging trends indicate such expansion will be in the best interest of the state of Washington;

NOW, THEREFORE, BE IT RESOLVED, By the Senate, the House of Representatives concurring, that a Joint Select Legislative Committee on International Trade, Tourism, and Investment be created to:

(1) Encourage the appropriate expansion of international trade, tourism, and investment;

(2) Determine the economic impact of international trade, tourism, and investment upon the economy of the state of Washington;

(3) Evaluate current state laws in relation to encouraging appropriate international trade, tourism, and

investment;

(4) Evaluate current administrative programs for the development of international trade, tourism, and investment;

(5) Develop proposals of possible alternatives for structuring of state programs to further enhance trade, tourism, and investment;

(6) Assess the need for state-federal coordination of policies and programs;

(7) Develop models by which state government and the private sector may work together on an ongoing basis to foster a favorable climate for international trade, tourism, and investment;

(8) Develop a Washington state policy statement to ensure viable international business programs; and

(9) Develop appropriate legislation to begin implementation of a state policy relating to international trade, investment, and tourism; and

BE IT FURTHER RESOLVED, That the Joint Select Committee on International Trade, Tourism, and Investment shall be composed of the President of the Senate as Chairman, the Speaker of the House, and from the Senate and House of Representatives the majority and minority leaders, the chairmen of the majority and minority caucuses, the chairman of the Senate Committee on Commerce and Labor, the chairman of the House Committee on Labor and Economic Development, and the chairman of the House and Senate Subcommittees on International Trade. If a committee member resigns or is temporarily unable to attend committee functions or activities, a member of the same chamber may be appointed by the President of the Senate or the Speaker of the House, as appropriate, to fill the vacancy; and

BE IT FURTHER RESOLVED, That the Office of the Governor, the Department of Commerce and Economic Development, all Washington ports, all governmental units interested in the enhancement of international trade, and the private sector in pursuit of its goals are requested to cooperate and provide information to the Joint Committee in carrying out its

HOUSE CONCURRENT RESOLUTION NO. 4

State of Washington
47th Legislature
1981 Regular Session

by Committee on Labor & Economic Development and Representatives Patrick, Sanders, Scott, Flanagan, Smith, Garrett, Brown, Barrett, Hankins, Clayton, Eberle, Warnke

Read first time February 3, 1981, and referred to Committee on LABOR & ECONOMIC DEVELOPMENT.

WHEREAS, The state of Washington is a governmental entity which can guide, direct, and influence economic conditions affecting foreign commerce, businesses, and trade, including the economic and physical environments; and

WHEREAS, The state of Washington has a primary interest in the formulation and implementation of legislation and policies relating to the economy and has an obligation to promote and protect the interest of its citizens in these matters because of their dependence on the international exchange of goods and services and all other commerce; and

WHEREAS, The stronger the consensus of all branches of government behind policies relating to economic enhancement the greater is the state's ability to influence all related policies, legislation, and administrative actions;

NOW, THEREFORE, BE IT RESOLVED, By the House of Representatives, the Senate concurring, That it is the policy of the legislature of the state of Washington to encourage all segments of state government to give strong consideration to measures which will assist the development of domestic and international commerce by:

(1) Working with local governments to help define the future growth needs of the economy of the state;

(2) The formation and operation of a legislative committee for primary consideration of all state legislation affecting international trade, business, and economic relations;

(3) The passage of legislative measures which will:

(a) Encourage future employment, tax revenue and a healthy environment;

(b) Provide an optimum competitive status regarding taxation of the exchange of goods and services;

(c) Encourage and monitor the investment of foreign capital within the state of Washington;

(d) Facilitate provisions for financing, constructing, and maintaining the most modern technological facilities for trade;

(e) Encourage intergovernmental trade missions and visitations to officials of our state's overseas trading partners to promote the growth of trade relationships;

(f) Recognize the need for development of an adequate and effective data base with computerized collection and retrieval capacity for trade promotion, evaluation of foreign market potential, identification of the origin, destination, and movement of commodities, and projection of the revenues derived from these activities; and

(g) Encourage the planning and funding of a balanced development of intermodal transportation facilities to better accommodate commodity movements; and

BE IT FURTHER RESOLVED, That it is the policy of the legislature of the state of Washington to:

(1) Take steps to increase the awareness of all branches of government of the importance of international trade and business to the state of Washington;

(2) Provide for a review of existing laws and rules which may have an inhibiting effect on our state's foreign trade and business; and

(3) Support education, information, and research programs to raise the public level of awareness of the importance of international business to the economy of the state of Washington.

Adopted by the House February 20, 1981.

Speaker of the House.

Adopted by the Senate April 9, 1981.

John A. Cherberg

President of the Senate.

TANNERS' COUNCIL OF AMERICA, INC.
2501 M Street, N.W. • Washington, D.C. 20037 • (202) 785-9400

Statement of
Eugene L. Kilik, President
Tanners' Council of America

Although the U.S. leather tanning industry is relatively small, its role in international trade is unusually important. It is an industry engaged in processing a valuable agricultural raw material. Because every country in the world has some of this raw material, international competition for markets and raw material supplies is intense. World economic and political conditions are often reflected in this industry before they are discernible elsewhere.

Recent developments in the hide and leather international trade point to issues which are likely to be concerns of U.S. foreign trade in the months ahead. Lessons learned in this industry will have applications for U.S. relationships with many of its trading partners and for U.S. trade policy in general.

In an effort to resolve trade problems and to reverse the trend toward protectionism, the United States concluded several bilateral agreements with other countries - Argentina, Brazil, Uruguay and Japan - specifically related to trade in hides and leather. None of these agreements are working. Some countries are actually in default of fulfilling these agreements.

In consideration of concessions given by the U.S., the Government of Argentina agreed to replace the complete ban on its exports of cattlehides with an export tax which would be gradually reduced to zero by October 1981. The Government of Argentina has failed to live up to its schedule of export tax reduction and is now in default of its commitment under the agreement.

Using the U.S./Argentine agreement as a model, the U.S. Trade Representative made similar agreements with Brazil and Uruguay. These agreements were never implemented by the countries involved.

Japan provides another sad tale. As a result of the U.S. tanning industry's complaint under Section 301 of the U.S. Trade Act, and U.S. threats of retaliation and complaint to the GATT, the Government of Japan agreed to allow a special quota for imports of U.S. leather into Japan. This agreement had two provisions. One increased the quota for U.S. leather imports into Japan; the second provided that the Government of Japan "facilitate implementation of the quotas." The Government of Japan did not live up to the second provision of its agreement. We now believe that the Japanese never intended to allow increased imports of leather, but used every excuse to avoid their commmitment.

Defaulting on an international agreement as Argentina did, or failure to live up to a commitment as the Japanese are doing, are serious breaches of trade behavior. There is no question that these actions reflect serious economic or social problems. They may be specific to the leather industry, but more likely, they are endemic to trade problems that are growing in every industry.

There is another aspect of international trade in which the U.S. tanning industry has great concern. This lies in the decline of industry competitiveness because of the recent realignments of currency values. The resurgence in U.S tanning activity in the past year was led by increased foreign sales of leather. In 1980, U.S. exports of leather reached almost $275 million, about double what it was four short years ago. Currently, however, trade reports are that export bookings are down approximately 80% from what they were a year ago. At the same time, contracts for leather imports are double last year's. These figures are startling because of the competitive advantage the U.S. industry has enjoyed in recent years.

So far this year, actual shipments of leather for export are roughly the same as they were last year. However, the effects of the recent decline of our sales and the increase in purchases will be felt in dramatic fashion in the coming months. We feel that this erosion in our industry's international competitiveness is something which will be reflected very soon throughout the entire range of U.S. manufacturered goods.

It is impossible for the industry to tell whether or not its change in competitiveness is a short-term disequilibrium which will run its course, or whether the strength in the U.S. dollar is a permanent readjustment in currency values. Whichever eventually proves to be the case, it is important to recognize the fact that the U.S. balance of trade is in for a considerable shock in the months ahead.

The recent problems of the U.S. tanning industry must be taken as symptomatic of the problems that lie ahead for many U.S. industries. U.S. policy must be adjusted to take into account these recent changes. We have some suggestions for Congressional and administrative action.

Trade agreements that were signed in good faith by the U.S. Government must not be allowed to be abrogated, ignored or circumvented. The Congress must stand behind the Administration and urge firmness in dealings with our trade partners. Most of these agreements have had the objectives of increasing freedom of trade in one form or another. If there is not to be a flight toward protectionism, these agreements must be enforced and expanded so that trade and consequent prosperity will be fostered.

The issue of changed currency relations is more difficult to tackle. While it is certainly true that domestic considerations must be in the forefront of establishing monetary policy, this policy's long and short effects on international trade should not be ignored. We urge the Congress and the Administration to take into account the international ramifications of monetary policy in overall economic planning. Destruction of competitiveness that has been built up through years of effort cannot be allowed to take place unless there is overriding need for such action.

We are grateful for the opportunity to present our views on these trade issues. We hope that they will be considered in reviewing and formulating policies that will lead to increased prosperity in the U.S. and in free market economies all over.

Eugene L. Kilik
President
Tanners' Council of America

July 24, 1981

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE SENATE COMMITTEE ON FINANCE

STATEMENT OF CHINOIN PHARMACEUTICAL & CHEMICAL WORKS LTD. AND CHEMOLIMPEX FOREIGN TRADE COMPANY FOR CHEMICALS

Chinoin Pharmaceutical and Chemical Works Ltd. ("Chinoin") and Chemolimpex Foreign Trade Company for Chemicals ("Chemolimpex") respectfully submit this statement in support of a renewal of the President's waiver authority under Section 402 of the Trade Act of 1974, and to clarify certain matters concerning a dispute between certain U.S. and Hungarian firms over industrial property rights.

Chinoin is a corporation organized under the laws of Hungary and has its principal place of business in Budapest. Chinoin has been engaged for 70 years in the manufacture and sale of chemical and pharmaceutical products throughout the world. Chinoin is a manufacturing company organized for profit and is not an organ or instrumentality of the Hungarian government.

Chemolimpex is a foreign trade company organized under the laws of Hungary and having its principal place of business in Budapest. It exports and imports chemical products to and from Hungary, including products of Chinoin. Such products encompass agricultural chemical products such as pesticides. Chemolimpex is an international trading company organized for profit and is not an organ or instrumentality of the Hungarian government.

Chinoin and Chemolimpex are particularly grateful for the opportunity to submit this statement in light of certain misunderstandings regarding alleged Hungarian patent practices in the agricultural chemical industry. Although these misunderstandings have perhaps persisted in some quarters for several years, they have been repeated most recently in connection with S. Res. No. 153, 97th Cong., 1st Sess., 127 Cong. Rec. S6404 (daily ed. June 17, 1981) which calls on the President to resolve a "long-standing dispute over the recognition and protection of industrial and property rights provided for in Article V of the Agreement On Trade Relations between the United States and Hungary . . . ." In their explanatory comments, sponsors of that resolution referred to an alleged Hungarian practice of hindering the patentability in Hungary of agricultural chemicals invented by U.S. companies and the alleged disregard by Hungarian firms of patent rights held by U.S. chemical manufacturers in third countries.

We explain below why these allegations are incorrect and provide no basis to suspend the extension of nondiscriminatory treatment to the products of Hungary. We also demonstrate that U.S. firms seeking patent protection in Hungary have been and are treated on an equal basis with Hungarian firms and that Hungarian firms do not infringe any patent rights of U.S. agricultural chemical producers in third countries.

History of the Present Controversey

In October, 1978, the National Agricultural Chemicals Association ("NACA") and several U.S. chemical manufacturers approached the U.S. Department of Commerce seeking direct governmental assistance in their attempts to reach a commercial solution with Hungarian chemical manufacturers on patent issues. On June 11, 1979, an *ad hoc* working group of the U.S.-Hungarian Joint Economic and Commercial Committee convened in Budapest to discuss settlement of outstanding patent issues. NACA representatives and member companies participated.

Since the organization of the *ad hoc* working group, various efforts have been made to resolve amicably and in a commercial setting the concerns which gave rise to the formation of that group. As a result of these efforts, all disagreements have been resolved with the exception of certain exports by Chinoin and Chemolimpex to Brazil.

These Brazilian exports are at issue in litigation between two Brazilian companies: FMC do Brasil (FMC Corporation's Brazilian subsidiary) and Biagro, a Brazilian firm which is a customer of Chemolimpex but is not a subsidiary or affiliate of Chemolimpex or any other Hungarian firm. No Hungarian firm is a party to that litigation. The dispute arose only after FMC, which formerly supplied the product in question to Biagro, stopped selling that product to Biagro and began selling through its own Brazilian subsidiary. Biagro then turned to Chemolimpex to replace its supply needs formerly filled by FMC.

In this area as well, a number of meetings have taken place between representatives of Chemolimpex and Chinoin on the one hand and FMC and others, on the other, in an attempt to negotiate a mutually satisfactory solution. These attempts, to date, have not borne fruit, due to FMC's position substantially to the effect that any negotiations must begin and end with the unqualified recognition on the part of Chinoin and Chemolimpex that their exports to Brazil infringe FMC's allegedly valid Brazilian patents. Since the Brazilian patent situation appears strongly to favor the position of Biagro, as explained below, meaningful negotiations clearly could not take place in that framework.

Thus, the suggestion that there are widespread disputes between Hungarian firms and U.S. firms is highly misleading. In fact there is but one dispute, in one country (Brazil). As explained below, it is open to extreme doubt whether FMC has any valid patent rights for the product at issue in Brazil, there are numerous legal grounds on which FMC's asserted rights are contested in good faith, and the matter in any event is before the courts of Brazil to be resolved according to the law of that country.

As we also demonstrate below, there cannot be any good faith claim that U.S. firms applying for patents in Hungary receive anything other than the treatment accorded to Hungarian nationals. The U.S. agricultural chemicals industry has recently so conceded, and statistics of the Hungarian patent office for the past 15 years vividly demonstrate the point.

National Treatment

It has been alleged that the Hungarian patent authorities act on the applications of U.S. firms in a manner that is somehow different from the treatment accorded Hungarian firms. This allegation is completely untrue, as NACA has recently conceded:

> The Hungarian patent office has, in our view, clearly provided our companies with "national treatment." . . . [W]e believe your government is committed to providing true "national treatment" to American companies.

Statement by Dr. Jack D. Early, President of NACA, Before the Working Group of the U.S.-Hungarian Joint Economic and Commercial Committee at 2, 3 (May 11, 1981).

The actual statistics of patent applications in Hungary dramatically demonstrate that Dr. Early's conclusion is entirely correct. According to the Patent Gazette [Szabadalmi Kozlony] of the Hungarian National Office for Inventions, from 1966 through 1980, U.S. firms filed 134 applications for patents relating to agricultural chemicals. Of those applications, only 5 were opposed by Hungarian firms. Of those opposed applications, the oppositions to one were withdrawn and it was granted; three applications were withdrawn by the applicants; and one was granted over opposition but subsequently lapsed for nonpayment of required annual fees. Of the 129 unopposed applications filed during this period, all were granted. Thus, of the 134 patent applications filed by U.S. firms during the past 15 years, a total of 131 or 98% were granted.

The Patent Gazette also reflects that from 1966 through 1980 Hungarian firms filed 77 patent applications relating to agricultural chemicals. Of those applications, 10 were opposed and all such oppositions are pending as of this writing. The remaining 67 applications have been granted. Thus, only 87% of the applications filed by Hungarian firms during the past 15 years have been granted.

We submit that these statistics hardly suggest a pattern of discrimination against U.S. applicants but, to the contrary, demonstrate that U.S. applicants enjoy a rate of success at least equal to Hungarian applicants.

The discussion about the so-called national treatment issue has often been marked by a lack of complete information. For example, the alleged difficulties of the U.S. firm, Monsanto Company, respecting certain of its Hungarian patents, are frequently cited. Monsanto was most recently mentioned in the explanatory remarks accompanying S. Res. No. 153. In fact, the Monsanto issue was amicably resolved over two years ago and vividly demonstrates the extent to which this Subcommittee has not had the benefit of all the facts.

The Monsanto matter involved a dispute over a herbicide. Part of the dispute turned on an application for a Hungarian patent relating to that herbicide which Monsanto had filed in 1971 and which several Hungarian companies, among them Chinoin, had opposed (under the established legal procedure described below) on various legal grounds including inadequate disclosure and lack of novelty. On July 19, 1979, Monsanto, Chemolimpex and another Hungarian company signed a cross-licensing agreement which resolved the dispute. As part of the settlement, the Hungarian companies withdrew all oppositions to Monsanto's pending application and the application subsequently was granted.

There appears to be a misconception on the part of some U.S. chemical firms that the procedure of filing opposition or cancellation proceedings somehow reflects a lack of "national treatment." This is not the case. These procedures are established by Hungarian law as the method for testing the legal sufficiency of any patent or patent application, regardless of the patentee's or applicant's nationality. In this respect, Hungarian law and practice closely resemble the established procedures and laws of most industrialized nations of the world including the United States. In Hungary, as in the United States and most other industrialized countries, these procedures begin at the administrative level and may ultimately be carried to the Hungarian courts for final resolution.

Further, the mere filing of an opposition in no way operates to interfere with the applicant's preliminary patent protection during the pendency of the proceeding. In Hungary, a patent application is published after the patent authorities have investigated the application. Upon publication, the applicant enjoys a preliminary patent protection which continues until final decision on the application. This preliminary protection becomes final if (a) no opposition is filed within three months of publication or (b) any opposition proceeding is ultimately determined favorably to the applicant. If the patent protection thus becomes final, it runs retroactively from the date of filing of the application.

Patent Disputes in Third Countries

This Subcommittee in the past has heard numerous references to the alleged disregard by Hungarian chemical firms of industrial property rights of U.S. firms in third countries. The explanatory comments accompanying S. Res. No. 153, 127 Cong. Rec. S6404-S6405 (daily ed. June 17, 1981), repeat these allegations. The allegations are incorrect and do not reflect all the facts.

With one exception, there are at this time to the best of our knowledge no disputes anywhere in the world between any Hungarian chemical company and any U.S. chemical company respecting any alleged disregard by any Hungarian firm of the industrial property rights of a U.S. firm in a third country. There is, in fact, only one dispute, which is now in litigation, and no Hungarian firm is a party to it. That dispute is between FMC do Brasil, the Brazilian affiliate of FMC Corporation, and Biagro, a Brazilian corporation. The litigation concerns only one product (Carbofuran) and one market (Brazil).[1/]

We note at the outset that the dispute is now before the courts of Brazil. The dispute turns on a number of legal issues which must be tried in those courts and not in the U.S.

1/ A prior dispute involving claimed third-country patent rights of Dupont Company was fully resolved in 1979.

Congress. Nevertheless, we offer a brief explanation of the factors involved in this dispute in order to bring the matter into perspective.

Carbofuran, the product at issue in the Brazilian dispute, is the generic name for a chemical substance that can be used for combating harmful insects. This substance, just as many chemical substances, may be produced by different and completely independent processes. While the processes for producing Carbofuran may be patentable, Carbofuran as such is not patentable under the laws of either Hungary or Brazil. FMC neither has nor claims to have such a patent in either country.

FMC likewise has no patents in Hungary for producing Carbofuran, nor has FMC ever applied in Hungary for any such patent. Chinoin does produce Carbofuran in Hungary under a process over which Chinoin holds a valid Hungarian patent and which is completely different from FMC's process for producing Carbofuran. FMC claims no patent in Brazil or anywhere else in the world over the process employed by Chinoin for producing Carbofuran. Indeed, Chinoin's process produces Carbofuran of 85 percent purity, whereas FMC has stated that its process is only capable of producing Carbofuran of 75 percent purity. Once Carbofuran is produced, it is normally formulated with a carrier such as talc, clay or liquids in order to render it into a more useable form. Carbofuran is sold in the form of the resulting composition for agricultural use.

Neither Chinoin, Chemolimpex nor any other Hungarian firm sells in Brazil any composition containing Carbofuran. Chemolimpex does sell in Brazil the Carbofuran produced by Chinoin's patented process. Biagro is the purchaser, who, in turn, formulates and sells in Brazil a composition containing the Carbofuran thus purchased from Chemolimpex.

As explained above, the Carbofuran purchased from Chemolimpex is produced by a process which is completely different from the FMC process. The heart of the Brazilian controversy, however, is FMC's claim that it enjoys patent protection over any composition containing Carbofuran, irrespective of the process used to produce the Carbofuran. Hence, FMC contends that the composition formulated and sold by Biagro infringes FMC's alleged patent protection in Brazil.

Biagro disputes this contention on a number of legal grounds, among which, as we understand it, is a provision of Brazilian law which forbids a patent over any product produced by chemical processes but rather provides that only the process is patentable. Title I, Chapter II, Art. 9(b) of the Brazilian Industrial Property Code (Law No. 5.772 of Dec. 21, 1971) states:

> The following shall not be patentable:
>
> substances, materials or products obtained by chemical processes or means--however, processes for obtaining or transforming such substances, materials or products shall be patentable . . . .

Another legal basis for Biagro's position is that FMC's Brazilian patent appears to duplicate an earlier patent held by the German firm Bayer. Biagro also contends that FMC has failed to use its Brazilian patent within the period required by Brazilian law.2/

There is, therefore, a serious question whether FMC enjoys the claimed patent protection in Brazil. In any event, the question is sub judice in the Brazilian courts. The litigation is between the two Brazilian firms concerned and no Hungarian firm is a party. In consideration of the fact that a chemical substance manufactured and sold by our firms is involved in the dispute, however, we have agreed to participate in further discussions with FMC in Budapest on July 31, 1981, which we hope will facilitate an amicable resolution satisfactory to all concerned.

2/ Under Brazilian law, a patent may lapse if the invention which it covers has not been effectively exploited within 4 years from issue, or within 5 years where a licence of exploitation has been granted. Title I, Chapter XVI, Art. 49, Brazilian Industrial Property Code (Law No. 5.772 of Dec. 21, 1971).

Senate Resolution No. 153

We understand and respect the motives of the six distinguished United States Senators who submitted S. Res. No. 153. In the interest of fairness, however, as well as in order to present to the Senate a balanced and accurate picture of the subject matter of the resolution, the factual background against which it was proposed requires correction and amplification.

To name just a few, the following assertions at 127 Cong. Rec. S6404-S6405 (daily ed. June 17, 1981) need comment.

1. We are unaware of even a single instance in which any Hungarian products were, through any acts or omissions of any Hungarian company, "passed off" as products of a U.S. company.

2. As indicated above, only a single patent infringement dispute exists at this time, namely the FMC Brazilian situation. That dispute involves complex questions of fact and law now pending before the only bodies capable of effectively resolving them, the courts of Brazil. While it is certainly true that patent suits can be lengthy, complex and expensive, litigation is generally accepted throughout the civilized world as a proper method of resolving patent disputes.

3. It is not true that the 1979 product catalog of Chemolimpex contained U.S.-origin proprietary technology.

4. Neither Chemolimpex nor Chinoin has sold Furadan (an FMC trademark) in Brazil or elsewhere. As described at an earlier portion of this statement, Chinoin and Chemolimpex have manufactured and sold the active ingredient Carbofuran to a Brazilian buyer. That buyer, in turn, has resold our product only under the name "Carbofuran" and not "Furadan." According to reputable Brazilian patent counsel, such sales are fully permitted under Brazilian law.

5. The characterization of negotiated attempts to resolve the Brazilian patent dispute as good faith efforts by FMC is open to reasonable doubt. A negotiating position which begins with a flat demand that Chinoin and Chemolimpex concede in their entirety the patent issues presented to the Brazilian courts by FMC, more closely resembles an ultimatum than an attempt to negotiate in good faith.

6. Chinoin and Chemolimpex have no competence to speak for the Hungarian government or any agency or instrumentality thereof; the purpose of bringing the above facts to the Subcommittee's attention was, rather, to indicate the difficulties inherent in a one-sided approach to an international trade dispute with numerous legal and factual ramifications and contested points of view such as here presented. We do not anticipate, and would not ask, for these disputes to be resolved in our favor before this body. By the same token, we do not consider it either fair or appropriate that any part of the dispute in question be so resolved against us.

7. Chinoin and Chemolimpex continue to believe that full and fair commercial negotiations are a mutually attractive alternative to litigation in resolving international commercial disputes of this type. They will continue to be ready to engage in such negotiations in good faith in order to resolve amicably their remaining differences with FMC.

Respectfully submitted,

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BY HAND

July 24, 1981

Honorable John C. Danforth
Chairman
Subcommittee on International Trade
Senate Committee on Finance
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Hearings of July 27, 1981, Respecting Renewal of the
President's Waiver Authority under Section 402
of the Trade Act of 1974

Dear Mr. Chairman:

Enclosed is a statement which our firm is submitting in the above matter on behalf of our clients, Chinoin Pharmaceutical Works Ltd. and Chemolimpex Foreign Trade Company for Chemicals. We submit this statement in support of a renewal of the President's authority to waive the emigration requirements under Section 402 of the Trade Act of 1974, and to clarify certain matters concerning a dispute between U.S. and Hungarian firms over industrial property rights. We demonstrate:

1. That previous allegations respecting the claimed lack of "national treatment" in Hungary for U.S. patent applicants are incorrect and that such allegations can no longer in good faith be viewed as a genuine issue in this matter, inasmuch as the National Agricultural Chemicals Association has conceded that U.S. firms receive "national treatment" from Hungarian patent authorities;

2. That previous allegations of disregard by Hungarian chemical firms of U.S. firms' industrial property rights in third countries are incorrect and exaggerated, because

there is in fact only one dispute over the industrial property rights of a U.S. firm in a third country (Brazil) and no Hungarian firm is a party to the resulting litigation;

3. That this one dispute concerns only one chemical product in one market and turns on complex legal and factual issues which are disputed in good faith by the parties concerned and which are now pending before the courts of Brazil;

4. That the factual background against which S. Res. No. 153 was proposed thus requires correction and amplification in order to present a balanced and accurate picture of the matter, and that it is neither fair nor appropriate to resolve, for or against any party in this matter, a complex international trade dispute without considering the views of both sides.

We request that you make this letter and the enclosed statement a part of the record.

Respectfully,

George G. Lorinczi

Enclosures: Five copies
of Statement

STATEMENT

OF

JOSEPH E. CONNOR
CHAIRMAN
PRICE WATERHOUSE & CO.

U.S. POLICY ON INTERNATIONAL INVESTMENT

WHAT IS IT? WHAT SHOULD IT BE?

In the United States today there appears to be a new awareness of the need to participate more realistically and meaningfully in the international economy. We are no longer living in a world where reliance on our domestic markets and our own economic resources is sufficient to maintain our important economic position.

As a result, considerable attention is now being given to finding ways to improve our country's international economic competitiveness. Part of that attention has correctly focused inward. The Administration's position is that the United States cannot compete effectively on a worldwide basis unless our domestic economy is strengthened, and its proposed program of tax and budget cuts is designed to help meet this objective. Other attention has been directed outward to our trade and investment relationships with other countries. Typically when considering these relationships, we have been largely preoccupied with trade issues and have devoted far less attention to our international investment position.

We agree that trade issues are important, but international investment policies must receive increased attention. We should not wait for a crisis. A positive program to facilitate U.S. direct investment overseas should be developed and our policy of neutrality toward inward investments should be reaffirmed.

To elaborate on our position, the remainder of this statement will discuss the following points:

- U.S. direct investment overseas can benefit the U.S. economy by helping to increase our exports and by reducing the need for foreign aid.
- The U.S. government policy of neutrality towards foreign investment and pursuit of national treatment, as articulated in 1977, is a sound one. But, failure to implement it fully has placed U.S. business at a disadvantage in dealing with restrictive investment practices by host country governments.
- The private sector needs more support from the U.S. government in overcoming tax and nontax barriers and restrictions to foreign investment in other countries. This support should take the form of a sustained, aggressive program to achieve national treatment of U.S. investment by host governments.
- National treatment can best be achieved through negotiation of equitable bilateral tax and investment treaties with host governments.
- In working to promote the free flow of U.S. investment abroad, certain U.S. government policies which impede such investment must also be addressed.

The Benefits of U.S. Direct Investment Abroad

In seeking to improve the international competitive position of the United States, the positive benefits of U.S. investment abroad cannot be overlooked, including increased exports and some reduction of foreign aid.

Trade and investment flows are closely related. Studies have shown that increased investment abroad should result in increased exports. This should be especially true in the developing countries. U.S. investment in such countries can strengthen their domestic economies by bringing in new capital, generating local tax revenue, and providing jobs, infrastructure, new technology, and a market for local resources and raw materials.

Thus, the ability of host country governments, businesses and individuals to purchase capital and consumer goods and services from the United States is enhanced.

Furthermore, in the case of both developed and developing countries, the establishment of local subsidiaries is an effective way of overcoming trade barriers which the exact same merchandise might encounter if produced and exported by a domestic U.S. company. In other words, foreign direct investment makes possible the penetration of export markets which might otherwise be closed to U.S. businesses. Our major trading partners realized this fact some time ago. That is one reason why foreign companies are now establishing subsidiaries in this country to manufacture goods for sale in our domestic markets.

In cooperation with the U.S. Council of State Chambers of Commerce, Price Waterhouse recently completed a study entitled U.S. Investment Abroad. The study shows that such investment is indeed beneficial to our economy, and that it has not contributed significantly to the economic ills often attributed to it. For example, there was no evidence of significant loss of domestic markets by U.S. based companies due to competition from U.S. affiliates abroad, or of loss to U.S. foreign affiliates of export markets which could have been supplied by U.S. based companies.

Briefly, our study suggests four ways in which establishment of foreign affiliates by U.S. companies may impact U.S. trade:

1. The domestic supply linkage. Estimates are that a major portion of the initial fixed investment of U.S. manufacturing affiliates abroad is spent to import U.S. equipment, materials and services. These initial imports lead to long-term and secure export markets for replacement and spare parts.

2. Sales to local market. Official data and survey evidence indicate that 75-80% of sales of foreign affiliates are to the local market. Opponents of foreign investment claim that these exports are in large part displacing exports from domestic U.S. companies and therefore robbing U.S. citizens of jobs. The study, however, contends that the markets being supplied by U.S. foreign affiliates could not have been served effectively from a U.S. export base. The markets would instead have probably been lost to foreign competition.

3. Stimulation of exports through foreign affiliates. The fact that a company has a foreign "presence" with established sales and service networks raises sales of product lines from the United States which are not produced in the foreign affiliates.

4. Sales from U.S. foreign affiliates to the U.S. market. Potential competition with U.S. products from goods produced by foreign affiliates is a possible negative impact of foreign investment. However, evidence indicates that the magnitude of the problem is relatively small. (Further data concerning this factor is presented below).

The study, due to be released in published form later this month, discusses each of the above factors in greater detail. A prepublication draft is included as an attachment to this statement.

Other studies have also been performed which support the thesis that U.S. investment abroad benefits our domestic economy. One of the best-known is the research series developed by Business International, Inc. (BI) entitled The Effects of U.S. Corporate Foreign Investment. This series, initiated in 1970, was undertaken specifically to test the so-called job-export theory, i.e., U.S. investment overseas results in unemployment at home. It is based on the results from questionnaires submitted to a sample of U.S. manufacturing and petroleum companies, including some of the largest and most prominent corporations in the United States.

The latest volume in the BI series covers 1979 and includes summary data for the period 1971-1979. Some of the key findings, as quoted from the study, are as follows:

- Exports: The sample's exports increased more rapidly in 1979 than total U.S. manufacturers' exports (18.2% vs. 8.6%). Firms in the sample with higher percentages of foreign investment increased their U.S. exports faster than did those with lower levels of foreign investment.

- Employment: Highly foreign-investment-oriented U.S. companies increase U.S. employment faster than other U.S. manufacturing firms. Overall U.S. employment in manufacturing rose 4.4% during the 1970-79 period. For the companies in the sample, total U.S. employment rose by 27.8% and net employment rose by 14.2%. Over the 1970-79 period, the firms in the sample investing the most outside the U.S. increased their U.S. net employment by 21.3%, while those investing lesser amounts outside the U.S. increased U.S. employment by 7.5%.

- Import Competition: Imports by the manufacturing companies in the sample from their foreign affiliates as a percentage of sales to U.S. customers were a mere 1.1% in 1970 and 2% in 1979. The proportion of imports of finished goods by manufacturing companies from their foreign affiliates to total imports fell during the 1970-79 period.

- Balance of Payments: Total remittances to the U.S. (of dividends, branch earnings, interest, royalties and fees) for the sample rose from $1.4 billion in 1970 to $4.5 billion in 1978 and $7.4 billion in 1979.

  The gross balance-of-payments surplus of the sample reached $17 billion in 1979, while the overall U.S. payments position was in heavy deficit.

The above data suggests that U.S. investment overseas is beneficial to the economy and does not lead to net domestic unemployment.

Interestingly enough, to our knowledge no recent study has been performed which directly correlates U.S. export and investment flows on a country-by-country basis over a number of years. We believe such a study might prove useful in making a strong case for increased U.S. investment abroad.

Finally, in the less developed countries, U.S. investments can help accelerate the modernization and growth processes and thereby lessen to some extent the requirement for official international assistance. For example, the U.S. Agency for International Development program in Egypt has been providing approximately $850 million of economic and technical assistance annually in recent years. An important portion of such assistance is directed toward promoting the industrialization process through improving productivity, developing opportunities for foreign private investment and expanding the private sector role in the Egyptian economy. To the extent there is an increase in U.S. foreign investment in Egypt, there should be an increase in demand for U.S. exports and a lessened need for such massive amounts of foreign assistance.

Impact on the Private Sector of Failure to Implement U.S. Investment Policy

Contrary to the claims of some, the U.S. government does have a stated policy on foreign investment, but it has not been fully implemented. Little progress has been made in achieving the policy's fundamental objective of preserving the free international flow of capital. Barriers to inward foreign investment continue to exist in many countries and, regrettably, new ones are being instituted by some countries. These barriers may take the form of laws and requirements which apply to all business, both domestic and foreign, but which in practice are particularly burdensome for foreign-owned companies; or they may take the form of direct restrictions and requirements which apply only to foreign investment.

The current U.S. Government position on international direct investment was set forth in a July 6, 1977, policy directive released through the State Department. This document stated that:

> The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward investment flows or activities. This policy is consistent with and reaffirms our longstanding commitment to a generally open international economic system.

The directive went on to affirm that "the United States has an important interest in seeking to assure that established investors receive equitable and non-discriminatory treatment from host governments."

Accordingly, one objective of the United States government should be to "obtain equitable treatment for investors consistent with such principles as national treatment of established firms and compliance with international law."

Price Waterhouse fully endorses the commitment to an open international economic system, and we strongly believe that the United States should work to ensure that every country pursues the objective of "national treatment" toward foreign investment. Governments should not treat foreign-owned companies any more or less favorably than they treat domestically-owned companies.

For its part, the United States government should not retreat from its long-standing policy of neutrality toward inward investments for what at best may well be short-term benefits. But, it must be more aggressive in seeking the elimination of restrictive investment and trade policies and practices of other governments. We should build bridges rather than walls.

While foreign investment in the United States has grown dramatically, in the overall context of the American economy the foreign presence is relatively small. More importantly, total American direct investment abroad is almost four times as large as its counterpart in the United States. We realize that certain interests are protesting what they consider to be "the selling of America" to foreign investors. However, we can hardly expect equitable treatment of U.S. investors overseas if we unduly restrict the opportunity of foreign businesses to participate in our economy.

What's needed now is heightened pursuit of overseas investment by U.S. business. We must be tough business competitors, and our government officials must be firm in ensuring national treatment by host governments. A good place to begin to exhibit this attitude is the upcoming economic summit conference in Ottawa.

Unfortunately, in the past, our policy of neutrality has too often been interpreted as a "hands-off" position. U.S. companies seeking to invest abroad may receive no hindrance from U.S. government officials here or in the host country, but neither do they always receive active assistance in obtaining equitable treatment. Furthermore, overall, there has been no clear U.S. strategy or sustained, aggressive effort to obtain national treatment in host countries.

This "arms-length" stance of our government places U.S. companies in a weak negotiating position in trying to overcome discriminatory treatment, especially in countries where the government and the local private sector are working in close harmony to promote and direct economic development. Thus, so-called neutrality in practice often generates inequities, in direct contradiction to the objectives set forth in the 1977 directive.

New Support for Private Sector Investment Efforts: Pursuit of National Treatment Through Bilateral Negotiation

If the United States government is committed to a policy of economic revitalization and accepts that direct investment overseas by American companies is one way of achieving this objective, then it is time for the government to be more supportive of private sector efforts to overcome discrimination against inward foreign investment in countries where it exists.

This does not mean that the U.S. government should become a partner in promoting U.S. investors' interests. It also does not mean greater government control of business. It means, quite simply, the reaffirmation and implementation of all aspects of the 1977 directive. Specifically, the U.S. government should work actively, in cooperation and consultation with the private sector, to achieve national treatment of U.S. investment by host governments. We need do no more than this, because by doing so we will be in a better position to overcome barriers to the free flow of investment which currently impede U.S. companies' ability to operate or expand overseas.

We endorse U.S. participation in multilateral efforts to overcome barriers to the free flow of international investment, such as the activities of the Organization of Economic Cooperation and Development (OECD). We feel, however, that the most effective way to achieve national treatment of U.S. investment abroad is through bilateral negotiation with host governments in countries where U.S. business already has a strong investment position, as well as in countries where increased U.S. investment would be desirable. In pursuing such negotiations, the experiences of U.S. businesses which have encountered discriminatory practices firsthand would be invaluable.

Tax Treaties

One of the most powerful instruments of bilateral negotiation is the tax treaty. The United States currently has tax treaties with forty-nine countries (see Exhibit at end of statement). But, many of these treaties do not address all significant tax barriers to direct U.S. investment, and we have not negotiated tax treaties with most developing nations, the more advanced of which are promising locations for investment. While significant progress has been made, the U.S. government must work even more aggressively to achieve national treatment of American investment through negotiation of bilateral tax treaties. Following are some of the significant issues which such negotiations might address.

Imputation System: The usage in many developed countries of the imputation system for taxation of companies and their shareholders has been identified as a major tax exception to national treatment. Under such a system domestic shareholders can offset against their own income tax liabilities all or a part of company income tax attributable to dividends received, or they can claim a refund on that basis. The same benefit, however, is not available to foreign shareholders, resulting in the payment of higher taxes to the host government. Consequently, U.S. investors, for example, may be reluctant to invest in countries where the system is in effect. Such countries, however, include Belgium, Denmark, Canada, Germany, England, France, Italy and Japan, so U.S. investors have the difficult choice of either avoiding a number of promising investment sites or simply paying the higher taxes.

Of all countries with imputation systems, only the United Kingdom has taken significant steps to extend a comparable benefit to foreign shareholders. This has been done through a modification of the tax treaties to which the United Kingdom is a party, including a treaty with the U.S. A few other countries provide some relief for foreign portfolio investors, but they do not extend the benefits to foreign direct investment. The United States should vigorously pursue this matter in treaty negotiations and be prepared to offer reasonable concessions in return. Perhaps compromise on the state unitary tax issue should be considered to the extent allowable under the U.S. Constitution. Outside of the treaty network, we are in favor of overall legislation to restrict the unitary method of state taxation.

Royalties and Head Office Expense: Developing countries have frequently formulated their tax codes from vastly differing economic, social and industrial perspectives than those found in developed countries. Partially for this reason, they have tended to formulate tax policies which discriminate against foreign-owned companies.

A good example of this is in the royalty area. Many developing countries, including Brazil, Chile, Colombia, Ecuador and the Philippines tax royalty payments to foreigners on a gross basis without allowance for expenses incurred in earning the royalty income. In addition, some countries (notably Brazil) do not allow the payor a deduction for the royalty payment, in effect treating the payment as a dividend. Another area of discrimination is the disallowance of expenses incurred overseas on behalf of a subsidiary in the developing country or the disallowance of the subsidiary's share of head office expenses. This practice is found in Colombia, Mexico and the Dominican Republic, among others.

These royalty and head office expense policies are often established because the developing countries are concerned over the outflow of local currency and the exchange problems it could create, rather than because they are attempting to actually discourage foreign investment.

Tax Sparing Credits: It appears that a major impasse in establishing a treaty network with developing countries is the issue of tax sparing credits. In an effort to encourage foreign companies to establish local manufacturing facilities, many developing countries will offer tax holidays and other tax credits to foreign entities. However, such credits are useful only if the company achieves an overall tax savings. To the extent the savings are offset by an increase in the home country tax (i.e., a corresponding reduction in the foreign tax credit available to U.S. companies), the incentive for investment is lessened. Some developing countries take the position in treaty negotiations that the developed country should allow a "tax sparing credit" with respect to the tax holidays and incentive credits. This means that the developed country would allow a foreign tax credit in an amount which would have been allowed had the company not been given a tax holiday or incentive credits in the developing country.

While we do not feel that such "tax sparing credits" are in accordance with national treatment, we believe that consideration should be given to compromise on this issue, providing a tax treaty can thereby be negotiated which achieves an overall movement towards national treatment (e.g., if the developing country will compromise the royalty and/or head office expense issues). Several other developed countries have allowed "tax sparing credits" in their treaties with developing countries.

Investment Treaties

Tax barriers are not the only impediment to United States investment overseas. Would-be investors frequently encounter nontax barriers as well. These may include a lengthy and complex application and approval process; specified performance requirements which must be met; local content requirements specifying that goods manufactured by foreign subsidiaries contain certain amounts of local materials; prohibition of foreign ownership in certain sectors, such as banking, insurance, transportation and the media; restriction of foreign equity participation to a certain percentage; joint venture requirements; restrictions on repatriation of capital or profits; exchange controls; employment restrictions, such as a ban on employment of expatriates or requirements that a certain percentage of foreign nationals be employed; and restricted access to credit in the host country.

Such restrictions are most frequently encountered in developing countries, where the national governments are likely to be deeply involved in directing and controlling economic activity. It is in these countries where American companies seeking to invest most need the cooperation and support of the U.S. government. Again, we feel that bilateral negotiations are the most effective approach to overcoming investment barriers.

An effort by the Office of the U.S. Trade Representative to negotiate a Bilateral Investment Treaty with the government of Egypt has been underway for some time. Among other objectives, this treaty is intended to ensure national treatment by both governments. We support the investment treaty concept as a viable instrument for achieving equitable treatment of U.S. investment abroad, especially in the developing countries. We also commend the Reagan Administration's commitment to raising the priority of overseas investment issues, as evidenced by the appointment of an Assistant U.S. Trade Representative for Investment Policy.

There are increasing signs that developing countries are becoming more and more open to foreign investment. Many lack the capital necessary to finance economic development. Understandably, however, they want some assurance that foreign investment will benefit their economies, while investors in turn want an environment conducive to profitable business ventures and protection from expropriation. Investment treaties appear to be the best method for providing such mutual assurances.

U.S. Government Impediments to U.S. Direct Investment Abroad

Our discussion of national treatment would be incomplete if it did not point out that the United States government has not in all respects provided for national treatment of its own business community. Curiously, some government policies impacting overseas investment by American companies have resulted in far less equitable treatment of such investment than the treatment extended to inflowing investment of foreign corporations.

These policies, such as taxation of Americans working abroad, have placed U.S. companies at a comparative disadvantage in competing in the international economy. We know that steps are being taken to deal with this and other similar problems, and we applaud them. We view such efforts as encouraging signs that Congress and the Administration recognize the need for positive measures to restore U.S. competitiveness, rather than restrictive actions to guard against foreign competition. We hope they are only the first in a series of efforts to strengthen the international position of U.S. business.

The job of restoring U.S. international competitiveness in foreign trade and investment involves not only removing existing disincentives, but also providing new incentives which match those of our international competitors. One such incentive which merits support is the U.S. Trade and Development Program. The program has been particularly valuable in identifying and planning development projects abroad which can result in expanded U.S. exports and investments during project implementation.

* * * * *

We cannot emphasize too strongly the need for the U.S. government to maintain its new-found international perspective as it fashions trade and investment policy. We must preserve our own policies of openness and neutrality and be aggressive in encouraging other countries to do likewise. We cannot allow shortsightedness, economic isolationism, and a failure to recognize the interaction between economic and political policy to recreate the disadvantages and disincentives which confront us today. Only through continued sensitivity to the new order of worldwide economic interdependence will we make genuine progress towards rekindling U.S. competitiveness in the international economy.

EXHIBIT

U.S. TAX TREATIES

The U.S., as of June 30, 1981, has income tax treaties in effect with the following countries:

Antigua(1)
Australia
Austria
Barbados(1)
Belgium
Belize(1)
British Virgin Islands(1)
Burundi(2)
Canada
Denmark
Dominica(1)
Falkland Islands(1)
Finland
France
Gambia(1)
Germany
Greece
Grenada(1)
Hungary
Iceland
Ireland
Italy
Jamaica(1)
Japan
Korea
Luxembourg
Malawi(1)
Montserrat(1)
Netherlands
Netherlands Antilles(3)
New Zealand
Norway
Pakistan
Poland
Romania
Rwanda(2)
St. Christopher, Nevis
and Anguilla(1)
St. Lucia(1)
St. Vincent(1)
Seychelles(1)
Sierra Leone(1)
Sweden
Switzerland
Trinidad and Tobago
Union of South Africa
USSR
United Kingdom
Zaire(2)
Zambia(1)

Notes:

(1) 1958 extension of the United Kingdom treaty.
(2) 1959 extension of Belgian treaty.
(3) 1955 extension of The Netherlands treaty.

ATTACHMENT

U.S. INVESTMENT ABROAD

A DRAFT STUDY

BY

PRICE WATERHOUSE & CO.

AND THE

U.S. COUNCIL OF STATE CHAMBERS OF COMMERCE

SUBMITTED TO

THE SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY OF THE SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

AND

THE SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE SENATE COMMITTEE ON FINANCE

July 13, 1981

CHAPTER I

The Importance of U.S. Investment abroad for the American economy

Introduction

During the post-war period, U.S. policy has been to encourage international trade and facilitate international investment by U.S. companies. This liberal policy position was based upon two presumptions. One is that freer trade and investment, as long as fairly and reciprocally implemented, improves the international allocation of resources and raises domestic economic well-being by increasing productivity and lowering prices. The second was that higher levels of international private investment would aid the development of friendly poor countries, and would complement and perhaps substitute for official development assistance.

The result has been dramatic. Facilitated by technological revolutions in international communications and transportation, this policy stance has made international trade expand at a faster rate than U.S. and world production; and has allowed foreign investment by national companies to expand even faster than trade. For example, from 1950 to 1978, the value of world production (in current prices) grew at an average rate of about 7%; world trade expanded at annual rates of over 9%, while foreign production of U.S. companies grew at almost 11% per year.

This growing international interdependence has been accompanied by relative domestic economic prosperity in the advanced industrial countries, including the United States. Yet, in the past twenty years, the U.S. has lost international market share in exports, has been exposed to growing competition from imports, and has not kept pace with many industrial countries in growth in income per capita. This has led to a questioning of the appropriateness of a liberal trade and investment policy for the U.S. economy, and has fueled protectionist and restrictionist sentiments in organized labor and some industries.

This chapter focuses on foreign investment by U.S. companies and makes two basic points. First, foreign investment and production by U.S. companies is good for the American economy overall, and has not contributed significantly to the economic ills often attributed to it. Second, U.S. tax policy with respect to U.S. investment abroad has been approximately "neutral," and could not undergo major change without adverse economic consequences for the domestic economy.

The impact of U.S. foreign investment on the domestic economy

The magnitude of U.S. direct investment abroad is substantial. At the end of 1978, the estimated book value of U.S. company investment abroad was $168 billion; by the end of 1979 the total was $193 billion. This compares with an investment of $41 and $51 billion by foreign companies in the United States on the same dates. U.S. investment abroad increased by about 140% from 1970 to 1979–a rapid rate of growth even after discounting for inflation.

In 1978, about 45% of U.S. foreign investment was in manufacturing industries; almost 20% was in petroleum; 9% was in other extractive industries; and about 27% was in services. The analysis which follows applies mainly for manufacturing, since this sector is the focus of controversy over its impact on domestic employment, competitiveness, and the balance of payments. U.S. foreign investment in services, petroleum, and other extractive industries is rarely viewed as having any significant adverse domestic economic consequences.

Over 70% of U.S. investment abroad is in the advanced countries, and almost one-third of that in Canada alone. This leaves only 30% of total U.S. investment in developing countries, and here a handful of countries–e.g., Mexico, Brazil, Taiwan, and South Korea–account for the bulk.

While foreign investment by U.S. companies is large in absolute terms, it is more modest when compared with the U.S. economy.[1] Table 1 shows the net outflow of capital (including retained earnings in foreign affiliates) and the total capital spending abroad by U.S. companies, both compared to domestic business investment in the United States. The final two columns show each expressed as a percent of domestic business investment. In 1978, the capital outflow for foreign investment was equivalent to 6.9% of domestic fixed investment, and that percentage has been falling since the mid-1970s. Total capital spending by U.S. foreign affiliates, which includes not only the capital outflows but also foreign borrowing by those affiliates, was equal to 12.6% of domestic investment. This ratio has also fallen since 1975, and both ratios are little different from their levels in the late 1960s and early 1970s.

These findings are consistent with those of the *Business International* (1980) survey of 97 large U.S. multinationals. For the manufacturing companies in that sample, the share of fixed assets of the companies held outside the United States rose from 20% in 1970 to 26.7% by 1977, but

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[1] The figures are official Department of Commerce estimates found in the *Survey of Current Business* (various issues)

Table 1

Foreign involvement of U.S. companies relative to fixed investment in the United States, 1960-1978

Annual average	Foreign direct investment flow	Fixed capital expenditure by majority-owned foreign affiliates of U.S. companies	U.S. business investment	(1) and (2) as a % of (3)	
	(Billions, $)	(Billions, $)	(Billions, $)	(Percent)	
1960-1962	2.77	4.0	48.7	5.7	8.6
1966-1968	5.30	9.1	84.3	6.3	10.8
1970-1972	7.88	15.0	107.1	7.1	11.7
1975	14.35	27.0	148.7	9.7	18.7
1978	16.70	30.7	243.5	6.9	12.6

Source: U.S. Department of Commerce, *Survey of Current Business*, various issues.

remained almost constant in 1978. Thus, the idea that U.S. companies are recently accelerating their foreign activities *relative to domestic operations* is not borne out by the data. Foreign investment and production in manufacturing is rising at a rate similar to that onshore.

The economic effects of foreign investment on the domestic economy take several forms. It may be helpful to review the process of foreign investment so as to identify the possible economic impacts.

Foreign investment occurs when a U.S. company raises some capital in the United States and increases its production facilities abroad—through expansion of existing facilities, building a new plant, or acquiring a foreign company. It then produces goods or services, employing local labor and other inputs, and often utilizes technologies developed in the United States and perhaps U.S. technical and managerial labor. The output of the foreign affiliate may be sold in the local market, exported to third countries, or exported back to the United States. The net revenue earned by the foreign affiliates will go partly to pay local taxes, may be retained for further expansion abroad, or may be remitted to the U.S. owners. The economic impact of this process on the U.S. economy is thus:

- *A balance of payments effect*
- *An impact on domestic production in the United States*
- *A change in domestic U.S. employment as a result of changing U.S. production levels*
- *An impact on the profits of the investing U.S. companies*
- *An impact on U.S. tax revenue.*

It should be noted that the critics of U.S. foreign investment focus their attention on the presumed displacement of U.S. jobs and production, and often ignore positive effects arising in the other areas identified above. There appears to be no vocal clientele to make the positive but unheralded case that foreign investment is good for the balance of payments and good for the profitability of U.S. companies.

As will be emphasized below, the net outcome of these effects may differ widely from company to company and from project to project, and will depend ultimately on whether the U.S. companies could have served the market in question from their United States facilities. The weight of the evidence indicates that, in most cases, the companies could not have captured or retained the markets in question and thus the net overall economic impact for foreign investment on the U.S economy is positive, even if difficult to observe. We turn now to some of that evidence.

Direct financial flows in the balance of payments

While American companies send funds abroad, they also receive major return flows in the form of dividends, interest and license and management fees. The $168 billion of existing foreign investment generates an impressive net financial flow for the U.S. balance of payments. This is shown in Table 2, for 1978, and for the cumulative period 1970-1978. For all foreign investment, the net positive direct financial flows were $73 billion for the period 1970-1978, of which foreign investment in manufacturing

Table 2

Direct financial flows relative to U.S. foreign investment, 1970-1978

(Billions, $)

	All sectors		Manufacturing	
	1978	**1970-1978**	**1978**	**1970-1978**
Gross outflow of equity and intra-company lending	4.6	37.2	1.0	15.8
Remittances of interest, dividends, and branch profits	13.6	83.4	4.4	24.3
Remission of fees and royalties	4.8	27.0	2.8	15.9
Net direct balance-of-payments impact	+ 13.8	+ 73.2	+ 6.2	+ 24.4

Source. *Survey of Current Business*, August 1979.

contributed about one-third. In 1978, the manufacturing contribution was almost one-half.

While these figures should not be construed to indicate that foreign direct investment is unequivocally good for the U.S. balance of payments, they do suggest that any adverse impact in the trade accounts would have to be significant to offset the positive effect of the financial flows. In addition, they imply that foreign investment is likely to pay for itself *in the long run*—at least in balance of payments terms.

The effects on U.S. foreign trade

While the direct financial flows associated with U.S. corporate investment abroad are visibly and definitely positive for the balance of payments, the impact of that foreign investment on U.S. exports and imports is also of critical importance in determining the overall effect on the balance of payments, and more important, on U.S. domestic production and employment. While net positive financial flows may be viewed favorably by stockholders and managers of U.S. multinationals, if these are associated with negative impacts on exports, imports, and domestic production, the economy and the balance of payments may be harmed overall even though those groups are benefitted.

When U.S. companies begin producing abroad through a foreign corporate affiliate, the potential impact on U.S. trade may take four forms.

1. The domestic supply linkage

Building and equipping the foreign production facility will result in higher exports of building materials and supplies, and of engineering services. In addition, foreign affiliates tend to order a large share of their equipment needs from the parent company or other U.S. suppliers. Earlier estimates (for the 1965-1973 period) indicate that at least 40% of the initial fixed investment by U.S. manufacturing affiliates abroad are spent on imports of equipment, materials, and services from the United States (U.S. Department of Commerce, 1969).

2. Sales to the local market

The output of foreign affiliates of U.S. manufacturing companies are mainly to the local market in which the affiliates operate. Official data and survey evidence indicates that 75-80% of the sales of foreign affiliates of U.S. companies are to the local market. Whether such sales help or harm exports from the United States revolves around one issue—could that local market have been supplied from the United States via exports. The answer depends on the trade and investment policies of the host country, and on the competitive environment in the industry. It is well known that many countries establish import barriers to force foreign companies to invest and produce locally. It has also been demonstrated that there are now more effective competitors with U.S. companies for world markets in almost every manufacturing industry in 1980 than there were in 1950 or 1960.[2]

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[2] For evidence on this point using market share and industry concentration ratio, see Vernon (1974) and Dunning and Pearce (1975).

Since such a major share of sales by U.S. foreign affiliates are to the local market, the total impact of foreign investment and production on U.S. trade is dominated by the assumption or assertion about the percentage of such sales which could have been made from the United States. If it is assumed, as is frequently done by critics of foreign investment, that most or all of these sales could have been made from an American production base, the inevitable conclusion is that foreign investment harms U.S. exports, production and employment overall. But such an assumption does not recognize the realities of the international competitive environment in 1980. In almost every manufacturing industry, there are fewer U.S. companies among the largest five (or ten) companies in that worldwide industry in 1975 than in 1965. U.S. companies are thus facing intensifying competition from larger and stronger foreign companies (Dunning and Pearce, 1975).

Companies invest abroad, not because they want to, but for one of two reasons. One is that the expected higher profits, due to lower costs, which the investment would allow is high enough to overcome the company's inertia and offset the higher risk, so that the investment is undertaken to the benefit of the company and the harm of the U.S. economy. The other is that the investment is undertaken to lower costs so as to be able to gain or preserve the market from lower cost suppliers from Japan, Europe, or even the developing countries. The rise since 1950 in the number of effective foreign competitors to U.S. companies in virtually every industry, together with the consistently shrinking share of U.S. companies in each industry in the world market, is strong evidence that the preponderance of foreign investment by U.S. companies is of the latter kind. That is, the foreign investment is largely defensive in nature, designed to preserve or raise market share in the face of intensifying foreign competition. This being the case, the foreign sales of affiliates do not displace exports because, in large measure, the markets could not have been served from a U.S. export base. In short, most of the exports would have been lost anyway, but to foreign suppliers rather than to foreign affiliates of U.S. companies.

3. Stimulation of exports through foreign affiliates

Foreign production units of U.S. companies obviously utilize some raw materials, components, and spare parts supplied from the United States. But the fact that a company has a foreign "presence," with established sales and service networks, raises sales of product lines from the United States which are not produced in the foreign affiliates. This serves to *stimulate* exports from the parent company, and the existence of this positive effect has been analyzed and documented in several studies.[3] Most U.S. multinationals are multiproduct firms, and frequently make some product lines only in the United States–for competitive reasons. Other lines are made abroad–again usually for competitive reasons. The sales and service efforts are more effective when a producing subsidiary exists than when exports are attempted through local distributors, sales agents or sales subsidiaries alone. In 1978, the manufacturing companies in the Business International sample sold almost one-quarter of their exports of finished products through their foreign affiliates (amounting to $5.6 billion). This effect is a positive one for U.S. exports, and for U.S. production and jobs.

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[3] For example, Lipsey and Weiss (1972), Horst (1974), Hawkins (1972) and Business International (1980).

4. Sales from U.S. foreign affiliates to the U.S. market

A possible negative impact on U.S. trade is the import of products produced abroad by U.S. companies to serve the U.S. market–whether cars, electronics, or chemicals. This phenomenon has received considerable attention, yet must be kept in perspective. First, the magnitude of such imports, although rising, remains quite small. In 1966, U.S. manufacturing affiliates abroad shipped slightly over 6% of their total production to the United States; by 1977 this had climbed to just under 10%. Another indication is that, for the manufacturing companies in the Business International sample, imports from their foreign affiliates accounted for only 3.4% of their total U.S. sales in 1978. Overall, the magnitude of the apparent problem is relatively small, although concentrated in certain industry sectors.[4]

Second, for these imports back to the U.S. to have a negative effect on U.S. trade (and production), it must also be true that the U.S. companies could have retained the sales from domestic production sites, in the face of competition from imports from non-U.S. companies. Given the policy of relatively unrestricted trade, some U.S. companies in, for example, electronics or automobiles, have found that their presence in the U.S. market could only be maintained by producing some products abroad and exporting them to the United States. Again, how important this defensive competitive reaction becomes is a matter of assumption and assertion, but the international competitive environment is such as to make a strong case that many of those imports could not have been competitively supplied from onshore production facilities.

The overall balance of payments effects

Putting together the disparate effects and evidence outlined above, what is the conclusion? On an annual-flow basis, the financial activities of U.S. multinationals are definitively positive. The impact on U.S. trade depends on how much of the foreign production of U.S. companies would have been carried out at home. If, as we believe, a substantial majority of that investment is to defend market share from foreign competitors, then the trade effects are also positive, or at best only slightly negative. Overall, then, the balance of payments would be favorable over the longer term.

Several econometric studies have been carried out to estimate the effects of U.S. manufacturing investment on the balance of payments. This has sometimes taken the form of estimating a "pay-back" or break-even period, during which the initial capital outflow is counterbalanced by net receipts on financial or trade accounts. An early noteworthy effort indicated that the pay-back period is in the range of 8 to 17 years, depending on the assumption of whether the foreign investment replaces domestic investment (Hufbauer and Adler, 1968). A more recent estimate by Choi (1980), utilizing data through 1978, indicated that the pay-back period is 5-6 years. These more sophisticated estimates are consistent with the data presented above, all of which suggest that the operations of U.S. companies abroad are, on balance, a positive influence on the U.S. balance of payments and trade.

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[4] Furthermore, these aggregate ratios of imports to foreign production or U.S. sales may be distorted by trade in autos and automotive products which have been greatly affected by the Canadian-United States Automotive Agreement.

U.S. production and employment

There is no doubt that U.S. multinationals close plants, move facilities abroad, and change the international pattern of production and trade. Indeed, multinational firms are among the most dynamic firms in the economy:[5]

- *U.S. multinational firms tend to have, on average,* higher *growth rates in domestic U.S. production and in U.S. employment than the average for all manufacturing.*
- *Such companies have a higher level of research and development expenditures and employees relative to sales or employment than the average for all U.S. manufacturing.*
- *Such companies export from the U.S. a higher share of their total sales, and have a higher growth rate of exports from the United States than the average for all U.S. manufacturing.*

Yet the charges that U.S. multinationals transfer jobs and undermine U.S. technological leadership persist and have recently intensified.

U.S. multinationals both create new jobs and destroy existing jobs. Several studies have concluded that the total number of jobs created may be more than the number of jobs destroyed.[6] This is a result of the fact that more home office jobs are needed to support foreign operations than domestic production operations, and that new production jobs created through expanded exports are almost equal to the old production jobs destroyed as a result of the cutback in obsolete product lines in the United States.

But more importantly, the characteristics, location, skill requirements, and industry of the domestic jobs created by foreign investment by U.S. companies is *different* from those which are phased out. The workers displaced as a result of foreign production of, for example, light bulbs, do not have the same characteristics, skills, or salaries as the jobs created by that offshore production through better sales and service of products exported by the same U.S. companies–e.g., gas turbines.

Studies have estimated the mix of jobs created versus jobs eliminated by foreign production of U.S. companies.[7] Using the input-out table and the industry skill and wage data, by industry, from the U.S. Labor Department, it was estimated that the average job created by foreign production of U.S. companies carried a salary almost $1,000 higher than the average jobs displaced. The skill mix of jobs created were more heavily weighted in the technical, professional, managerial and clerical ranks while those displaced were more heavily weighted in the skilled and unskilled production worker categories. While those estimates were based on the foreign production of U.S. companies in the late 1960s and early 1970s, recalculation of estimates using data for the mid-1970s indicates that the conclusions remain unchanged.

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[5] This was documented extensively for the 1960s See. e.g., U.S. Tariff Commission (1973) and Hawkins (1972) More recent studies reconfirm the findings. e.g., Business International (1980).

[6] See Stobaugh (1972) and Hawkins (1972)

[7] See Hawkins and Jedel (1975) and Webbink (1976)

The overall economic Impact

The above analysis and studies cited suggest that foreign investment by U.S. companies are beneficial for the U.S. economy in an overall sense. That does not suggest that some groups and some workers may not be harmed, but that the overall positive effects outweigh the negative impacts.

Multinationals are some of the most dynamic companies in the economy. Their foreign operations have become one of the most intense and direct linkages with other economies, permitting the worldwide exploitation of U.S. technology, and allowing U.S. companies to compete on even terms with ever-stronger foreign companies. To restrict or reduce that ability would have serious negative effects on the U.S. economy, cutting off U.S. companies from the competitive stimulus of foreign markets, reducing further our international competitiveness and stifling productivity growth and innovation.

Foreign investment has had positive effects on the U.S. economy. Almost every serious study concludes that foreign investment helps the balance of payments in the long run. The weight of the evidence also indicates that foreign production by U.S. companies does not erode our export position, and creates more demand for workers than it eliminates. This is true because most foreign investment is a competitive response to foreign companies seeking to capture actual or potential markets, both abroad and in the United States.

Foreign investment is a part of the dynamic response through which American industry adjusts to changing international economic conditions. It provides the opportunity for American workers to have skills upgraded and productivity increased, if retraining is provided. The jobs created pay more and have higher skill categories than those eliminated. To stifle this adjustment would tend to lock American industry into outdated production modes and low productivity activities. This would harm capital formation at precisely the time when higher investment levels are needed to raise lagging productivity growth and improve the international competitiveness of the U.S. capital base.

In addition, foreign production by U.S. companies provides a larger base for and higher return on new technology. If, as is commonly held, new research and development expenditures depends on its expected returns, then restricting U.S. companies to exploit their technology from U.S. production bases would, no doubt, retard the pace of new research and development.

U.S. tax policy and foreign investment

U.S. government policy toward the taxation of foreign income of U.S. companies has been one of approximate "neutrality." More precisely, it has sought to be a policy of "capital exporter neutrality," in which the tax system *per se* neither favors nor penalizes foreign investment over domestic investment, and thus lets market forces determine the investment decisions. Full capital-exporter neutrality implies that a company, looking at two projects–one foreign and one domestic–with the same expected rates of return, would receive the same worldwide tax bill on both, and thus the tax system would not affect the investment decision.

U.S. tax treatment approximates this situation. There are two main elements of note in the U.S. system. One is the U.S. income tax credit for taxes on foreign earnings paid to foreign governments. This credit is limited to the amount which would have been paid in U.S. taxes had the earnings been made in the United States. It thus effectively eliminates double taxation of earnings, but does not reduce the companies liability for taxes on earnings in the United States.

The second is the deferral provision, under which U.S. tax liability on earnings of foreign subsidiaries of American companies does not arise until those earnings are repatriated in the form of dividends to the American parent. This provision stems from the legal view of corporations as "corporate citizens," and that income should not be taxed until the domestic corporate citizen receives the actual payment, regardless of whether the domestic parent company has effective control over the income when earned. The deferral provision has been under attack for some time as "unfair" and for extending more favorable tax treatment to the earnings of foreign affiliates than to domestic companies.

The seriousness of this criticism is often overblown, however. Most industrial countries have profit tax rates that are not very different from the U.S. tax rates. Thus the tax bill for most foreign affiliate earnings has already been taxed by the host country when earned. In some developing countries, where the effective tax rate is sometimes lower than in the United States because of tax holidays and other incentives provided foreign investors, the advantage may be somewhat more significant.[*]

Two additional points are worthy of note. First, the United States does not treat foreign subsidiaries of its companies any more leniently than other major base countries for multinational firms, e.g., Japan, France and Germany. Thus, to apply less liberal tax policy to foreign earnings would place U.S. companies at a competitive disadvantage against foreign based companies.

Second, there remains a major departure from equal, or fully neutral, tax treatment for foreign operations which tends to favor investment in the United States over investment abroad. These are internal revenue code changes of the late 1960s and 1970s, which provide investment tax credits for qualified investments in plant and equipment, and accelerated depreciation allowances for writing off certain fixed assets. These provisions are not available for capital spending and depreciation by foreign subsidiaries of American companies. In addition, the provisions for Domestic International Sales Corporations (DISC) also relieves U.S. taxes on a part of earnings by domestic companies involved in exporting. These make the after-tax rate of return on domestic assets more attractive than that on foreign assets yielding the same pre-tax rates of return. Estimates indicate that these provisions are much more important in their impact on the total tax bills of American companies than is the deferral provision.* The deferral provision, to the extent that it does provide any lower tax rate on foreign earnings of U.S. companies, may be viewed as a partial offset to the several tax provisions which favor investment in the United States.

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[*] See Ness (1973).

Thus at present, U.S. tax policy toward foreign earnings, if one considers the foreign tax credit, deferral provision, and domestic investment tax credit and depreciation provisions is, if anything, biased against foreign investment and not in favor of it. This departure from full neutrality has occurred almost by accident, as provisions of tax credits for domestic capital spending and depreciation on domestic assets were not extended to foreign affiliates of U.S. companies.

Removal of the deferral provision, or changing the nature of the credit provision, would move U.S. tax policy further away from neutrality, and reduce the after-tax rate of return on U.S. investment abroad. Not only would this harm the return flow of dividend remittances, it would reduce the new outflow of foreign investment and lower the future benefits to the domestic economy outlined above–including its competitiveness, jobs and balance of payments. In an economic simulation of the impact of several tax policy changes on foreign investment by U.S. companies, it was found that the likely outcome of elimination of deferral and/or the foreign tax credit provisions would be a very significant impact on companies' returns, and therefore on their willingness to invest abroad (Kopits, 1980).

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*See Hufbauer (1975) and Kopits (1980).

CHAPTER II

Timing of the taxation of foreign subsidiary earnings

(The "deferral" issue)

Under current law, a U.S. corporation which undertakes foreign business operations may choose to structure its operations as:

- *Foreign subsidiaries*, whose earnings are generally subject to U.S. tax only when remitted back to the U.S. parent company; or
- *Foreign branches* of the U.S. corporation, whose earnings are taxable (or losses deductible) in the U.S. on a current basis.

Taxation of foreign subsidiaries

Of the two approaches, however, U.S. corporations normally conduct overseas activities through subsidiaries organized in the countries where the operations are located. Under U.S. tax law, the earnings of such subsidiaries are normally subject to tax when distributed as dividends to their U.S. parent corporation.

From time to time, critics of the present system have contended that the existing approach be changed to subject to immediate U.S. taxation the income of foreign subsidiaries. In effect, these critics advocate a system of anticipatory taxation, which would apply whether or not a foreign subsidiary had adequate cash available to pay a dividend after covering working capital and other investment requirements. Some have referred to such proposals as the "elimination of deferral," a semantic device which implies erroneously that the U.S. government at one time enacted deferral privileges to foster foreign investment.

In fact, the United States system of taxing foreign subsidiary income has developed in accordance with internationally accepted principles of taxation. *No country* has a system in which income earned by overseas subsidiaries and affiliates is currently taxed at home. Nevertheless, proposals to tax currently the earnings of U.S. owned foreign subsidiaries were very seriously considered in the Burke-Hartke Bill of 1972 and recommended by the Carter Administration in 1978. A study of this issue was conducted by a task force appointed by the House Ways and Means Committee, chaired by Representative Rostenkowski in 1977, which concluded that the present U.S. tax ground rules in this area are logical and soundly based and should be retained.

Effect of proposals to currently tax foreign income

If the United States were to change its tax laws to currently tax foreign subsidiary income, the effect would depend on the level of taxes being paid by all foreign subsidiaries in the aggregate. In many countries, the tax rate approaches or exceeds the U.S. 46 percent income tax rate. In such cases, allowable foreign tax credits would result in little or no residual U.S. income taxes.

In countries where the income tax rate is appreciably lower than the U.S. rate, large federal income tax liabilities would arise. This would make it difficult for U.S. companies to compete with foreign businesses in such countries.

It has been argued that termination of deferral would serve to make domestic investment as attractive as investment abroad. In fact, it would appear that the true intent is to strongly discourage foreign investment with the notion that this would lead to increased investment in the U.S. This view clearly ignores that beneficial contributions to the domestic economy (e.g., jobs, exports, balance of payments) made by U.S. controlled overseas subsidiaries. (See discussion in Chapter I.)

Although the acceleration of U.S. tax revenues as a result of anticipatory taxation would probably be marginal on an overall basis, the effect on individual U.S. corporations, as well as on specific business decisions, could be significant. For example, to the extent that business considerations would indicate that investments be sited in countries offering initial tax incentives, imposition of U.S. anticipatory taxation would offset any advantage of such incentives for U.S. corporations. The likely result would be loss of the business opportunity to a foreign-based competitor rather than additional U.S. tax revenues.

Also, in a world of fluctuating exchange rates, varying accounting principles and tax laws, language barriers, etc., there would be very substantial practical difficulties in determining the income of foreign subsidiaries based on worldwide application of the U.S. tax law. The present system, where income is recognized in the U.S. when dividends are remitted, is simple (by comparison) and practical from the standpoint of taxpayers and the Internal Revenue Service alike.

The U.S. tax system provides for the avoidance of double corporate taxation of corporate earnings domestically by eliminating, in whole or in major part, dividends received from other U.S. corporations when determining corporate taxable income. Such elimination does not apply, however, to dividends received from a foreign corporation, unless that corporation carries on its trade or business in the U.S. and is subject to

U.S. tax. Moreover, a foreign corporation's profits and losses cannot be included in a U.S. tax return, with minor exceptions.

Subpart F

The basic principal that a U.S. corporation is not required to recognize income earned by its foreign subsidiary until receiving a dividend from that subsidiary was modified by the introduction, in 1962, of the Subpart F provisions into the Internal Revenue Code. These are very complex provisions and will be treated only summarily in this booklet.

The intent of the Subpart F provisions is to ensure that a U.S. multinational does not employ artificial devices, involving the use of foreign subsidiaries, solely as a means to unreasonably reduce its worldwide tax burdens. Under Subpart F, the U.S. parent company of a foreign subsidiary is taxable on certain categories of income earned but undistributed by such subsidiary. The principal types of undistributed income which can be taxed in this way are lightly taxed investment income, tax haven sales and service company income as well as shipping and insurance income.

Taxation of foreign branches

While it is less common, some U.S. companies operate overseas through foreign branches of domestic subsidiaries. The U.S. tax treatment of such operations is explained in this section.

Under the U.S. Tax Code, domestic corporations, i.e., corporations organized under the laws of a State of the U.S., are liable for U.S. taxation on income from all sources, domestic and foreign. This is known as the worldwide (global) taxation principle. Accordingly, when a U.S. corporation carries on income-producing business activities outside the U.S., through a branch or division located overseas, or otherwise derives foreign income, the income earned abroad will be subjected to U.S. tax. Correspondingly, any losses resulting from an excess of expenses over income attributable to overseas activities are deducted from other income generated by the U.S. corporation.[1] In effect, a foreign branch or division is merely an extension of the U.S. corporation, as opposed to being a separate juridical entity, and the tax rules treat it accordingly. The branch form of operation abroad is commonly used by U.S. banks which are generally required to use branches rather than subsidiaries, and occasionally by other types of U.S. corporations for various reasons. U.S. tax on the income earned by the foreign branch can be reduced or eliminated by electing to claim a credit against the U.S. tax for the income tax imposed by, and paid to, a foreign government.

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[1] Various rulings and cases deal with the recapture of branch losses when the branch is incorporated as a foreign subsidiary

CHAPTER III

Purposes and application of U.S. foreign tax credit provisions

The nature and purpose of the foreign tax credit provisions of the U.S. Internal Revenue Code ("Code") are often much misunderstood, which fact seems to be in part responsible for the numerous legislative proposals of recent years aimed at limiting the use and effectiveness of the credit for U.S. corporations.

The retention of an effective, undiluted foreign tax credit mechanism is fundamental to the continued growth of U.S. international trade and overseas investment. The attacks on the foreign tax credit appear to stem primarily from a lack of knowledge as to what it is and how it works. It is therefore necessary to dispel the fundamental misconceptions regarding the foreign tax credit It should be understood that:

- *The foreign tax credit (or its equivalent) is not unique to the United States.*
- *The foreign tax credit does not discourage domestic investment nor does it encourage foreign investment.*
- *The foreign tax credit does not reduce the U.S tax liability on U.S. source income.*
- *The foreign tax credit is not a tax preference or loophole.*

In the material that follows, the basic purpose and mechanics of the U.S. foreign tax credit will be described briefly, with a view toward providing objective support and evidence of the four propositions stated above.

Purpose of the U.S. foreign tax credit

Historically, United States tax policy toward foreign business income has tended to achieve two major objectives: equity among taxpayers (with equity defined roughly as equal treatment for taxpayers irrespective of income source) and general tax neutrality with respect to foreign versus domestic source income (the absence of U.S. tax penalties or benefits on foreign versus domestic source income). Thus, U.S. tax policy has sought to prevent international double taxation and to minimize the role of taxes as determinants of business location.

The U.S., as well as other countries, recognizes that the foreign country in which income is generated has the primary right to tax such income, and in order to prevent the pyramiding of different layers of taxes on the same income, recognition is required to be given to the income tax imposed by the foreign country. Absent such recognition, confiscatory double taxation would result, and foreign business operations would be drastically curtailed or eliminated. Although the U.S. Code does provide a deduction for foreign income taxes paid by a U.S. taxpayer, experience has proven that a deduction does not adequately relieve the double taxation inherent in multinational operations. For example, if a U.S. corporation pays a 50 percent rate of tax to a source country, deducting such tax would result in a 73 percent overall tax burden, hardly an attractive tax cost to encourage business activities.

To avoid this type of result, most of the industrial nations of the world have adopted one of two systems designed to eliminate this adverse effect. One method is for a country to exempt foreign source business income realized by its nationals (France, Belgium, Netherlands). The other method, and the one which the United States employs (as well as such countries as Canada, Japan, Germany and the U.K.), is to tax worldwide income of its citizens while allowing a credit for foreign income taxes paid.

Accordingly, if the aggregate foreign tax applicable to foreign income, taxable in the U.S., is less than or equal to the U.S. top rate of 46 percent, that income will be subject to a total U.S. and foreign tax of 46 percent. If the aggregate foreign tax rate is higher than the U.S. rate, that income will be subject to a total foreign tax in excess of 46 percent, and no U.S. tax. The *overall limitation*, by its terms, requires the aggregation of foreign taxes and foreign income.

Who can claim the foreign tax credit

Foreign income is any income earned from sources outside the U.S. It may take the form of income attributable to foreign business activities, as well as actual dividends, royalties, rentals and/or interest income received from either foreign affiliates or unrelated foreign parties. It may also take the form of undistributed income of certain corporations, as provided in special rules in the Code (e.g., controlled foreign corporations, DISCs, etc.).

In general, any taxpayer subjected to foreign tax on the above items of foreign income, is entitled to claim the foreign tax credit. This chapter, however, will focus primarily on the credit as it pertains to corporations.

Creditable taxes

Taxes which are available for credit are foreign *income* tax liabilities incurred by a U.S. taxpayer, including foreign income taxes paid by a U.S. business on its overseas business activities as well as withholding taxes deducted at source on payments from abroad of, for example, dividends.

interest and royalties. Additionally, a U.S. corporate shareholder owning at least 10 percent of the voting stock of a foreign corporation may claim credit for an appropriate portion of the foreign income taxes *paid by the foreign corporation* on the earnings out of which dividends are paid to the U.S. corporation (the deemed paid credit).

The foreign tax must be an income tax (or a tax in lieu of an income tax), in the U.S. sense of that term, not a tax which is based on other criteria, such as on gross receipts, sales or value added. These other types of taxes are deductible as expenses if imposed on the U.S. taxpayer, but are not eligible for the credit. The Internal Revenue Service has issued guidelines setting forth its views as to the standards a foreign tax must conform to in order to constitute a creditable foreign income tax. Over the years, the Congress and the courts have evidenced the intention that the foreign tax credit provision be liberally applied, in the interest of fulfilling the original statutory mandate to avoid international double taxation.

The direct foreign tax credit

The term *direct* tax generally refers to a foreign income tax imposed directly on the U.S. taxpayer, including taxes paid on income from overseas business activities as well as foreign withholding taxes deducted from investment-type income. An illustration of the direct foreign tax credit is shown below:

	$
Royalty income from a foreign licensee	100
Foreign withholding tax at 15%	15
Net amount received	85
Included in U.S. income	100
U.S. tax thereon at 46%	46
Less–foreign tax credit	15
Net U.S. tax payable	31

The deemed paid foreign tax credit

As mentioned, a domestic corporation may be entitled to a foreign tax credit for income taxes which it has not itself incurred, but which are treated as if, or "deemed", paid by it. The taxes which are creditable under these rules are the foreign income taxes paid by a foreign corporation on the income from which it pays a dividend to a qualifying U.S. corporation. To qualify, a U.S. corporation must own at least 10 percent of the voting stock of the dividend-paying foreign corporation. Thus, a U.S. parent company receiving a dividend from a foreign subsidiary can credit against its U.S. tax not only the dividend withholding tax but also a portion of the foreign subsidiary's tax on earnings used to pay the dividend, provided that the deemed credit is added to the amount of the dividend for inclusion in income ("gross-up").

In addition, the Code contains rules which permit a flow through deemed paid credit for foreign income taxes paid by corporations indirectly owned (through other foreign corporations) by the U.S. corporate shareholder, provided certain requisite ownership thresholds are satisfied.

The amount of the deemed paid credit is that proportion of the foreign corporation's income tax liability that dividends paid to the U.S. corporation bear to the foreign corporation's total earnings and profits for the relevant year. The following example illustrates the calculation of the deemed paid foreign tax credit, assuming a 50 percent payout.

	$
Earnings before tax of foreign corporation for calendar year 1980	1,000
Foreign income tax at 40%	400
Earnings and profits for 1980	600
Dividend paid to U.S. parent company	300
Less–foreign withholding tax at 5%	15
Net dividend received in U.S.	285
Foreign creditable taxes:	
a. Direct credit for withholding tax	15
b. Deemed paid credit for subsidiary's tax:	
$\frac{\text{(Dividend) } 300}{\text{(Earnings and profits) } 600}$ x (Foreign tax) 400:	200
Total creditable taxes	215
Included in U.S. income:	
Gross dividend (285 + 15)	300
Plus: foreign deemed paid tax ("gross-up")	200
Grossed-up dividend included	500
U.S. tax at 46%	230
Less–foreign tax credit (above)	215
U.S. tax payable	15

Where the subsidiary is less than wholly owned, the investor's actual proportionate share of the foreign earnings and foreign taxes are used in the formula for determining the amount of credit and gross-up.

Limitation on amount of credit

If a U.S. taxpayer receives income from a foreign country which imposes its income tax at rates higher than in the U.S., the total creditable taxes would exceed the U.S. tax on that foreign income. Accordingly, the Code provides a limitation to ensure that a credit is not available to reduce the *taxpayer's tax on U.S. income*, by restricting the amount of credit which a taxpayer can use in any year to the U.S. tax on its *foreign source* *taxable income*. Although excess foreign tax credits which cannot be used in a particular year can be carried back two years and forward five years, in no event can they be availed of to reduce the U.S. tax on U.S. income. For example, if the foreign income tax appropriate to the dividend in the above illustration had been $250, the excess $20 would only be available as a credit against the U.S. tax on foreign source income in a carryover year.

The limitation is applied on a global basis, referred to as the "overall limitation". It results in an averaging effect when income is received from one or more high tax countries as well as one or more low tax countries. This can generally be beneficial, except in years in which the U.S. multinational has foreign operations which resulted in losses (other than losses incurred by separate foreign subsidiaries).

Allocation and apportionment regulations (1.861-8)

To arrive at foreign source *taxable* income for purposes of calculating the limitation, foreign source gross income *must* be reduced by the appropriate amount of expenses incurred and borne by the U.S. corporation in earning that income. In addition, however, to expenses directly related to earning foreign income (e.g., expenses of direct overseas business activities), the IRS also considers indirect expenses, including those incurred in the U.S., to be allocable to foreign income. The type of indirect expenses considered to be so allocable are, among others, general shareholder (investor) expenses, interest expense, and research and development expenses.

The practical application of this concept had presented difficulties for taxpayers for many years, during which time several sets of proposed regulations were issued. A final set of regulations was adopted in 1977 with effect for years beginning after December 31, 1976. The net impact of this regulation has been to reduce, sometimes dramatically, the credit limitation to many U.S. corporations with the resulting increase in their overall tax burdens. In particular, it has had an adverse impact on U.S. based research and development activities by requiring an apportionment of such expenses between foreign and domestic source income. The concepts embodied in the regulation tend to undermine the basis upon which the foreign tax credit system rests.

Conclusion

Although the foreign tax credit has survived reasonably intact over the years, attacks on it from time to time since 1960 have tended to make it more restrictive and less responsive to the need to maintain neutrality by eliminating the adverse effects on international trade arising from international double taxation. It is crucial that the nature and purpose of the credit be thoroughly understood in Congressional circles so as to end the perception that it is a gaping loophole in the U.S. Code. Without the credit, or some comparable relief mechanism, U.S. companies will be unable to compete in international markets, with all the detrimental effects on the U.S. economy that would ensue (as noted in Chapter I).

CHAPTER IV

Need for tax treaties

Background

Bilateral income tax treaties are negotiated and executed by nations for the primary purpose of avoiding double taxation and encouraging the free international flow of investment. In the treaty framework, the contracting parties sacrifice, by agreement, their statutory rights to some tax. Unilateral foreign tax credits and territorial exemptions eliminate double taxation to an extent, but the treaties go further in providing for procedures for allocating the right to taxation of certain types of income between the two jurisdictions. In addition, treaties provide for significant reductions in the rates of statutory withholding taxes, which is significant in many cases since these taxes are usually charged on gross income and there is a limit to the amount of foreign tax credit on the resulting net income that can be absorbed by the recipient. The negotiations themselves provide the tax authorities with a useful forum for cooperation and discussion of tax problems in the international area. In some cases, where local tax law is not clear, it helps the foreign investor to be able to rely on a treaty as regards a particular transaction.

For a capital-exporting country using the foreign tax credit system, such as the U.S., it is important to obtain a reduction in foreign tax from treaty partner countries to ensure that, as far as possible, the foreign tax burden does not exceed the U.S. tax on foreign income.

Although all tax treaties are bilateral and thus tailored to the facts, circumstances, aims and laws of the two nations involved, there has been a movement, particularly over the last 15 years, to standardize the treaties through the drafting of models by international organizations. The most recent model is the Draft Double Taxation Convention on Income and Capital of 1963, as last revised in 1977, developed by the Organization for

Economic Cooperation and Development (OECD). This Draft Model Convention and its commentaries have become a basic document in guiding national negotiators and their tax advisors in this important area of avoidance of double taxation of international business and investment.

Most of the many treaties now in force have been concluded between developed countries, which tend to be both capital exporting and capital importing and thus have common interests in such areas as reduction of withholding taxes on foreign investment income and royalties. Fewer treaties have been concluded between developed and developing countries because the latter are primarily capital-importing nations with different objectives and goals. It is interesting to note, however, that, resulting from recent East-West trade discussions, bilateral tax treaties were negotiated and executed between various governments of Western countries and the Soviet bloc nations.

U.S. treaty program

The provisions of a U.S. tax treaty generally override the provisions of the federal income tax laws. Although the U.S. treaties generally take precedence over the provisions of the federal income tax law, however, they generally do not at present extend to state and local taxes. It is thus not uncommon for income of a foreign corporation with some activities in the U.S to be exempt from Federal income tax under a treaty but to be subject to an income tax in one or more of the states. The U.S./U.K. treaty, signed in 1975 and ratified in 1980, originally attempted to influence state taxation by preventing states from applying the so-called unitary basis of assessment to U.K. controlled multinational groups. The attempt did not succeed as the U.S. Senate would not approve such a provision.

Negotiations with other countries are undertaken by representatives of the U.S. Treasury Department. The procedure is for the negotiators to agree on a treaty and to sign it. The signed treaties must then be ratified by the respective governments before they come into force. In the U.S., each treaty must be approved by the Senate and there are a number of treaties which the U.S. has signed but which were, for various reasons, not ratified by the Senate and eventually withdrawn.

The more recent U.S. tax treaties are based on the OECD Model. In 1977, the U.S. Treasury issued its own "model income tax treaty" representing the provisions which the U.S. would seek to have included in a U.S. treaty. The U.S. model broadly conforms to the OECD Model with some modifications for specific U.S. positions. A revised U.S. Model was issued in June, 1981.

Treaties with developing countries

The U.S. has an extensive network of tax treaties with the developed countries of the world. However, the U.S. has fallen behind many other European nations in successfully negotiating treaties with developing countries. This has principally been due to the fact that the U.S. has steadfastly refused to offer to the developing countries a so-called "tax sparing" credit, in accordance with which the U.S. would grant a foreign tax credit for taxes of a developing country that would have been paid but for a local tax holiday. At the moment, however, the U.S. is finding the developing nations more receptive to treaty negotiations because of their pressing need for foreign investment, particularly U.S. investment.

General pattern of U.S. treaties

Recent U.S treaties contain articles addressed to the following areas, which are discussed in more detail in the appendix:

- Scope of treaty
- Definition of treaty terms
- Industrial and commercial profits
- Taxable income of permanent establishments
- Shipping and air transport
- Affiliated enterprises
- Investment income
- Capital gains
- Individuals
- Double taxation
- Exchange of information

In particular, it should be noted that the article dealing with double taxation recognizes the U.S. foreign tax credit and supports it as a tool to eliminate international double taxation. Moreover, the articles dealing with affiliated enterprises and exchange of information serve to prevent abuse situations in the intercompany transfer pricing area.

APPENDIX CHAPTER IV

Description of typical U.S. treaty provisions

Scope

The initial articles generally define the taxes and persons covered by the particular treaty. In the case of the U.S., only federal income taxes are covered, but in the case of other countries local taxes on income are often included as well.

Definitions

The treaty next defines its terms and provides that any term not defined shall be interpreted under the laws of the country whose taxes are involved. The definitions include the various concepts of fiscal domicile and residence, terms which are of significance in determining the applicability of the treaty to items of income and the persons receiving them.

One of the most important definitions relates to the term "permanent establishment," which broadly means a branch, with limitations and extensions which vary from treaty to treaty to cover the many possible variations of activity and contact in a country by a foreign enterprise. The existence or absence of a permanent establishment affects principally the taxation of these activities.

Industrial and commercial profits

In the absence of a treaty, a U.S. enterprise with relatively inconsequential activities in a foreign country could become subjected to that country's tax. For instance, a U.S. corporation, merely selling goods to customers in a foreign country, could, depending on that country's tax laws, be considered taxable there with the threat of double taxation.

To avoid double taxation arising in cases where an enterprise is doing business *with* rather than *within* another country, the tax treaties generally provide for full exemption from tax in the host country. The treaties generally provide that industrial and commercial profits earned by a U.S. enterprise in the partner country will not be subject to tax in that country unless the U.S. enterprise maintains a permanent establishment in that country to which the income is attributable. If the activities amount to a permanent establishment, they are subject to tax under the country's normal rules, and double tax relief will generally be available only by means of the U.S. foreign tax credit.

The treaties contain slightly varying definitions of permanent establishment. However, a permanent establishment is generally present if manufacturing operations are carried on in the treaty country or if a sales office is maintained there. On the other hand, if the U.S. enterprise is merely exporting goods to the other country, it is generally possible to avoid having a permanent establishment by using an independent local commission agent to negotiate on its behalf, as opposed to maintaining an employee or exclusive agent in the other country.

Taxable income of a permanent establishment

Subsequent articles provide for the computation of taxable income when a permanent establishment exists. The basic principle followed is that the foreign enterprise is to be taxed on the income attributable to the permanent establishment as if it were a distinct and separate enterprise, dealing with its head office on an independent arm's length basis. Provision is made for head office expenses to be allocated where these are incurred for the specific benefit of the establishment or for the benefit of the group as a whole.

Shipping and air transport

The treaties generally provide for taxation of income from shipping and air transport in the country where the enterprise is headquartered or resident for tax purposes, and for exemption in the other country. Some treaties simply provide for exemption from tax for ships and aircraft registered in the other country.

Affiliated enterprises

The treaties provide that where enterprises are affiliated or under common control, their respective profits shall be determined on an arm's length basis. Recent treaties also provide for consultations between the governments when there are conflicting rules on this matter which result in double taxation.

Investment Income

The treaties provide for a reduction in the withholding taxes on dividends, interest, royalties and rentals. These reductions are intended to give recognition to the fact that the withholding taxes imposed at source are based on gross income and thus require a reduction to take into consideration the expenses of earning the income as well as in the interest of avoiding double taxation.

In the case of dividends, the withholding tax rate is usually reduced to 15 percent in the case of portfolio investments, i.e., individual investors and corporate investors with insubstantial holdings. Such investors would normally be able to claim a foreign tax credit for the withholding taxes. In the case of substantial holdings, however, the rate is generally reduced to 5 percent, on the basis that the income is still within the corporate group. Substantial holdings for this purpose vary, but 10 and 25 percent are the most common in the recent treaties.

In the case of interest income, a withholding of tax at source on gross, without recognition of the fact that the recipient has incurred interest expense, can result in excessive taxation. Most treaties between developed countries have recognized this problem and exempt interest from withholding tax entirely, in order to encourage fast and free flows of investment funds across borders. Some treaties limit the tax to 5 percent or 10 percent.

Royalties have similarly been exempted at the source in many treaties between developed countries, in the interest of encouraging the flow of know-how between their countries. Many treaties include equipment rentals and know-how payments in the royalty exemption. Industrial as well as cultural royalties are usually covered.

Real estate income and natural resource income are treated differently from the other kinds of investment income. The country in which the properties are located is given the right to tax the income. However, the recipient is sometimes given the choice of being taxed on a net income basis (at graduated rates) rather than a gross income basis (at a flat rate), in recognition of the heavy expenses usually associated with such income.

The new U.K. treaty contains an anti-avoidance provision which is also contained in the U.S. Model. The provision excludes certain holding or investment companies owned by third country nationals from the benefits of reduced rates on investment income. This is to combat the phenomenon known as "treaty shopping."

Capital gains

Except for real property and effectively connected assets, the treaties usually provide an exemption from the capital gain taxation of one country for residents of the other country. Thus, under most treaties a U.S. investor would not be subject to capital gains tax in the other country.

Individuals

The treaties usually provide for exemption from tax for visiting employees of enterprises of the other country, in addition to visiting directors, self-employed persons, students, trainees, teachers and government employees. There are also provisions to avoid the double taxation of pensions and for the prevention of tax discrimination against nationals of the other country.

Double taxation

Most treaties contain specific provisions to relieve cases of double taxation which might arise despite the treaty provisions. For example, the U.S. normally reserves the right to tax its nationals and corporations in full, but agrees to allow a foreign tax credit. Although the right to a foreign tax credit is contained in the U.S. statute, it is sometimes provided for in tax treaties, and with an occasional modification.

Most treaties provide for cooperation between the "competent authorities" (tax authorities) of the two governments involved in cases where double taxation might arise contrary to the spirit of the treaty. In the case of the U.S., the Commissioner of Internal Revenue has delegated the administrative functions of the "competent authority" to the Assistant Commissioner (Compliance) and the technical interpretative function to the Assistant Commissioner (Technical). The most typical situation where the competent authority mechanism is effective is in the area of intercompany transfer pricing, where crossborder, affiliated transactions are involved.

Exchange of Information

Most treaties contain provisions for the exchange of information between the governments in specifically delineated circumstances. This is an avenue of enforcement that governments are using more frequently in these days of increasing crossborder transactions.

CHAPTER V

Purposes and application of DISC provisions

Purpose of DISC

In 1971, the Congress recognized the need to encourage exports from the U.S., in the furtherance of domestic economic activity. It further recognized that one of the ways to encourage export activities was through the tax system. Accordingly, the Domestic International Sales Corporation (DISC) provisions were enacted at that time, effective in 1972.

The principal feature of the DISC provisions is that some portion of the export-related profits will not be subjected to federal income tax until they are actually or constructively distributed by the company earning them.

Types of DISCs

There are two types of DISCs, a buy/sell DISC and the more widely used commission DISC.

A buy/sell DISC receives orders directly from its customers, takes title to export goods for resale abroad, issues invoices in its own name, and collects accounts receivable from its customers.

A commission DISC earns a commission from participating in an export sale with its related supplier (usually the parent or a sister company), with the supplier continuing to perform all export functions Ordinarily, the DISC will earn a commission equal to the maximum profit it would be entitled to under special safe haven intercompany pricing rules if it were a buy/sell DISC. The regulations require that the related supplier must actually pay the commission within 60 days after the close of the DISC's year.

Qualification requirements

To obtain the DISC benefits, a non-manufacturing domestic corporation, engaged solely in export activities, must elect to be treated as a

DISC. There are a number of requirements to be met to qualify, the most important of which are these:

Gross receipts requirement

For each year, a DISC must derive at least 95 percent of its gross receipts from the sale or lease of export products manufactured in the U.S. or commissions from such export transactions. Also, certain specified types of interest income will qualify.

Asset requirement

To maintain DISC qualification, 95 percent of the corporation's total assets at each year-end must consist of export inventories, assets used primarily in connection with sale or lease of export inventories, accounts receivable and evidences of indebtedness arising in connection with export transactions, etc.

Taxation of DISC income to shareholders

A DISC, itself, is not subject to federal income tax. Rather, DISC income is taxed in the hands of its shareholders as a dividend when:

- *There is an actual distribution of DISC income;*
- *There is a deemed distribution of DISC income;*
- *DISC status is terminated, or when a shareholder sells his DISC stock and the gain realized reflects his share of untaxed DISC income; or*
- *The DISC pays any foreign bribe or participates in an international boycott.*

CHAPTER VI

Taxation of expatriate employees and the significance to employers

Introduction

The cost of maintaining U.S. employees abroad has climbed dramatically in recent years, primarily due to higher tax burdens, the complexity and uncertainty of the U.S. tax law as well as the administrative burdens thrust upon U.S. employers. This has resulted in a reduction of the number of U.S. expatriates employed abroad. Various industry groups have indicated the adverse effect of such cutbacks upon the level of U.S. exports and overseas business vis-a-vis foreign multinationals. It is for this reason that Congress is again re-examining the tax rules applicable to U.S. expatriates.

In order to persuade an employee to transport himself and his family to another country, a monetary incentive generally must be provided. The employer must provide the expatriate, through various allowances, with the means to reside under conditions similar to which he is accustomed at home, to educate his children as he would at home and to uphold the corporate prestige by living as well as his counterparts in the host country. In addition, the employer must reimburse the expatriate for excess tax burdens arising out of the overseas assignment (the excess of the U.S. and foreign taxes, including social security, over the tax normally paid in the U.S.).

Background to U.S. approach to expatriate taxation

The U.S. approach has been to tax U.S. citizens on worldwide income regardless of source, which is virtually unlike every other nation of the world where taxation is based on residency rather than citizenship. Double taxation on foreign income of U.S. expatriates, as in the case of U.S.

corporations, is avoided or minimized by the U.S. foreign tax credit. Until 1962, however, U.S. citizens resident abroad were allowed to exclude from U.S. tax *all* earnings for services performed outside the U.S., thus equating them substantially with nationals of other countries.

1962 saw the introduction of a limitation on the earned income exclusion of $20,000 per annum for the first three years of foreign residence and to $35,000 thereafter. In 1964, the $35,000 exclusion was reduced to $25,000. In 1976, the earned income exclusion was reduced to $15,000 and other very severe restrictions were imposed. However, because of the adverse impact of the 1976 amendments on the U.S. taxation of expatriates, particularly their impact on the overseas compensation costs to U.S. employers, the 1976 changes were replaced by tax provisions of the 1978 Foreign Earned Income Act.

The 1978 legislation replaced the long standing foreign earned income exclusion concept with a totally new concept allowing deductions for the excess foreign living costs incurred by U.S. expatriates on foreign assignment, such excess to be measured by comparison to the highest cost urban area within the U.S. The exclusion was retained at a level of $20,000 per year, but only for employees living in camps or compounds (usually employer provided) in designated hardship areas and only attributable to periods during the year when the employee actually resided in such camp or compound.

The 1962 amendments resulted in the filing of tax returns by U.S. citizens abroad, for the first time in many cases. However, the earned income exclusions plus the foreign tax credit still kept U.S. taxes at a minimal level for most U.S. expatriates. Moreover, their foreign tax liabilities were, with some notable exceptions, also maintained at acceptable levels through tax incentives granted by foreign governments and careful tax planning.

Thus, U.S. companies in the 1960's often adopted a very simple policy–high compensation for expatriates. U.S. citizens working in foreign locations were generally paid much better than employees of host country companies, because U.S. salary levels were much higher and it was necessary to use U.S. personnel to promote U.S. business and exports. The tax rules at the time did not necessitate the employers becoming involved in the personal tax affairs of their employees.

Present problems

Today, problems for U.S. multinational employers arise from a combination of factors. Inflation has caused sharp increases in salaries worldwide. As a result, U.S. salary scales are no longer substantially in excess of overseas executive salary scales. The new expatriate taxation scheme, excess foreign living cost deduction rather than a flat earned income exclusion, is not providing the relief anticipated by the supporters of the 1978 legislation, particularly in the housing area, which is the major cost area where foreign living costs exceed comparable U.S. costs, primarily because of technical deficiencies in the legislation itself. For a more detailed discussion of the current taxation rules and various tax reimbursement plans, see the appendix.

In addition, the IRS is examining more returns of expatriates than ever before, and imposing their restrictive interpretations of the statute to create deficiencies. The constantly changing legislative rules and the higher probability of IRS examination have made the preparation of expatriate tax returns more complex and have forced many U.S. companies to engage outside consultants to handle tax return preparation and tax planning for their expatriates, at not insubstantial costs.

Coupled with all this, foreign income tax rates have increased over the years and enforcement efforts are much more efficient in many foreign countries where U.S. expatriates reside. In addition, the tax authorities in countries with which the U.S. has an income tax treaty can and do ask the U.S. authorities to provide detailed data on U.S. citizens resident in their countries. Foreign social security taxes on individuals are becoming a significant cost in many European countries. Tax incentives available to foreigners with technical skills are gradually being withdrawn or limited.

Trends for the future

In the U.S., there continue discussions of how the income and allowances of U.S. citizens working abroad should be taxed. The current rules result, in the view of business, in too heavy a burden of taxation, borne in most cases by U.S. employers trying to compete with foreign-based multinationals. There is a movement in progress today, manifested by several bills introduced in the Congress, to return to a foreign earned income exclusion approach at levels substantially higher than the maximum exclusion levels contained in the prior law, for both reasons of simplicity and equity. For a detailed discussion of the current rules covering U.S. persons working abroad, reference should be made to "U.S. Citizens Abroad," one of a series of information guides published by Price Waterhouse.

APPENDIX CHAPTER VI

Current employer tax reimbursement plans

Introduction

In an effort to overcome the dilemma of providing monetary incentives for employees to move abroad without having them substantially eroded by taxation, multinationals have developed various arrangements, and thus have become involved in the personal tax affairs of their expatriate employees. Several approaches are briefly described below, the most common being "tax equalization." It is considered by most multinationals that tax equalization meets most of the following objectives for a good plan:

- *It must be fair to both the company and the expatriate and be easily understood by the expatriate;*
- *It must treat employees equally regardless of their geographic location;*
- *It must be structured so as to facilitate overseas transfers from the United States and transfers between two overseas posts; and*
- *It must compare fairly with current practices followed by other major multinationals.*

Laissez faire

Under this approach, the employer pays each expatriate employee a base salary plus the usual allowances, and leaves the employee responsible for paying his U.S. and foreign taxes. This was the approach used by most U.S. companies in the 1950's and early 1960's, which involved the simple technique of providing high amounts of compensation for expatriate employees and letting them handle their own tax affairs individually. This approach is rapidly becoming obsolete today for many reasons.

Ad hoc

Under this approach, the employer deals with each expatriate employee's compensation and tax problems on an individual basis. Any reimbursements of excess taxes would depend on the work location as well as personal factors. This method is suitable for multinationals with only small numbers of employees on international assignment. However, if large numbers of employees are sent overseas, the *ad hoc* approach is unsatisfactory and can result in internal difficulties among employees as well as administrative problems. As multinationals have sent greater numbers of U.S. employees abroad, the *ad hoc* approach has also become virtually obsolete.

Tax protection

Under this approach, the employer reimburses the employee for the excess of the actual foreign and U.S. taxes on his compensation over the tax which he would have paid if he had remained in the U.S. The employee is thus protected from paying higher taxes on a foreign assignment. If, however, the taxes incident to a foreign assignment are lower than the hypothetical stay-at-home tax, the employee reaps the benefit.

Tax protection is used today by some multinationals. Since, however, the employee is allowed to keep the difference if his actual tax is lower than the stay-at-home tax, there is created a tendency for the expatriate employees in low tax countries to resist transfers, thus restricting flexibility of staff movement. Further, there is an incentive for the employee to seek ways of reducing his local taxes which the company may consider undesirable. The cost of such a plan to the employer is also greater than a full equalization plan, under which an employee is not allowed to keep the difference in a lower tax country. Thus tax equalization has been slowly gaining ascendency.

Tax equalization

Under this approach, the expatriate employee's gross earnings are adjusted so that, in effect, his net after-tax income is what it would have been if he had remained in the U.S., plus the necessary incentive payments and allowances, net of tax. As under the tax protection plan, the employer reimburses the expatriate for the excess of the actual U.S. and foreign taxes over the hypothetical stay-at-home tax. But if the stay-at-home tax is higher than the actual tax, the benefit inures to the employer rather than the employee.

Although this philosophy does cause some complaints by employees assigned to relatively low tax areas where indirect taxes are high, this method (and variations thereof) are now being used by most international employers of expatriate personnel.

The technique for achieving tax equalization is to compute the hypothetical tax and to deduct it from the employee's base salary. Thus the employee's taxable income both for U.S. and foreign tax purposes is reduced by the hypothetical tax, whereas under a tax protection plan the hypothetical tax does not reduce taxable income. Overseas allowances are then added to the base salary reduced by the hypothetical tax to arrive at after-tax disposable income. The employer then reimburses the employee for *all* the actual taxes he incurs, as compared to reimbursing him for only the estimated additional taxes, if any, he incurs under the tax protection plan.

CHAPTER VII

The Importance of proper Intercompany transfer pricing rules and administration

Introduction

Where an international corporation operates abroad through overseas subsidiaries and affiliates, tax authorities in the various countries concerned, including the corporation's home country, generally view such a situation as presenting the taxpayer with opportunities to shift profits to low tax countries through the use of artificial transfer prices on intercompany sales of goods and services. In response to this perceived problem, tax authorities around the world have tended to react by adopting measures which have, in most instances, restricted this type of tax avoidance activity. The essential need is for a set of transfer pricing rules that is fair and equitable to the adopting government and, at the same time, not overly onerous and burdensome to the affected taxpayers. Overzealous enforcement by the agents of the various tax authorities concerned must be avoided, and reasonableness should be the order of the day, in order to shield multinational corporations from effective double taxation.

The U.S. was one of the earliest to move in the direction of providing taxpayers and tax enforcers with a set of cohesive rules to deal with the many manifestations of intercompany transfer pricing In fact, many other governments, as well as the OECD, have thoroughly familiarized themselves with our rules as a basis for formulating their own versions. Admittedly, the U.S. rules are far from perfect; nevertheless, they represent an attempt to provide objective criteria to use in evaluating intercompany transfer pricing structures, which have worked reasonably well in practice since they were promulgated as final regulations in 1968.

Section 482 of the Internal Revenue Code is the basis for government regulation of intercompany transfer prices. It has been in the U.S. law for over forty years. The section is one sentence in length and provides the

IRS with broad powers to allocate income and deductions among and/or between related businesses to more clearly reflect income and prevent tax evasion.

For some years, the IRS employed Section 482 only in extreme situations of income shifting among domestic taxpayers. During the decade of the 1950's, however, U.S. corporations greatly accelerated their business expansion abroad, establishing overseas manufacturing, sales and licensing companies. In some cases, corporate taxes abroad were lower than the U.S. corporate tax, and thus there were advantages to accumulating profits abroad.

To stem any tendency for profits to be shifted from the U.S. to foreign subsidiaries, the IRS, in 1961, instituted a vigorous enforcement program in the area of international operations, focusing principally on the reallocation powers of Section 482. In order to avoid retroactive adjustments and unanticipated deficiencies, U.S. taxpayers have generally sought to comply with the principles developed under this section. In regulations issued in 1968, practical guidelines were established as to how the Commissioner's broad authority under this section will be applied to the allocation of income and deductions, with particular emphasis on cases involving foreign income. These regulations and related rulings have generally accomplished their objective.

Scope and purpose of Section 482

U.S. Section 482 can apply in any case where two or more incorporated or unincorporated organizations, trades or businesses are controlled directly or indirectly by the same interests. The "reality" of the control is considered to be decisive and not its form or mode of exercise. A presumption of control may arise if income or deductions have, in fact, been found to have been arbitrarily shifted.

Allocations can be made not only to prevent "evasion of taxes" but also where considered necessary to "clearly... reflect the income" of each enterprise or group. The regulations emphasize this point by stating that an allocation can be made even where a shifting of income has occurred by inadvertence.

The overriding concept is one of strict recognition that each corporate entity within a controlled group is separate and distinct from other members of the group. The objective of the section is to determine the income of each separate entity as if it had conducted its affairs with other members of the group under the same terms and conditions generally applied in business dealings with non-related parties. This is commonly referred to as the "arm's length" principle. The regulations provide guidelines of how the IRS would expect related taxpayers to deal with each other on an arm's length basis, and in some instances also provide exceptions to this standard in the form of safe haven or formula approaches.

Methods of allocation

Where the IRS proposes to make an allocation under Section 482, the allocation can take the form of an adjustment to gross income, deductions, credits, tax basis of assets for depreciation or for gain or loss purposes, or any other adjustments required to reflect the substance of transactions. There is no authority under the section to disallow deductions or credits, but only to reallocate them among members of a group. In some cases, however, the reallocation of a deduction (e.g., to a foreign affiliate) is tantamount to disallowance in the current year.

The regulations provide that where the IRS has made an adjustment to one member of a group, a corresponding adjustment must be made to other members involved, whether it is a U.S. or foreign corporation. In addition, intercompany pricing adjustments are sometimes made on transactions involving two foreign affiliates of a U.S. corporation, with constructive dividend consequences to the U.S. parent.

Procedures under tax treaties[1]

The income tax treaties to which the United States is a party generally provide for the allocation of income and deductions on transactions between related persons in accordance with the arm's length standard. The treaties also generally show recognition of the problem of international double taxation arising from allocations when countries have different concepts of what constitutes arm's length dealing, and thus provide for settlement of taxpayer grievances by consultation between the "competent" tax authorities of the countries involved. However, these procedures have offered relatively limited usefulness in resolving conflicts in this area.

Specific guidelines

The U.S. regulations under Section 482 offer guidance on five specific types of intercompany transactions:

- *Intercompany loans and advances;*
- *Performance of services by one affiliate for another;*
- *Use of tangible property of one affiliate by another;*
- *Use or transfer of intangible property;*
- *Intercompany sales of personal property.*

Today, U.S. corporations, in hopes of avoiding subsequent reallocations which can lead to unanticipated tax liabilities, are in general attempting to follow the principles outlined in the guidelines, which are discussed in the appendix.

Effectiveness of the U.S. regulations

If it is assumed that Section 482 will continue to be vigorously enforced by IRS in transactions involving foreign affiliates (which is a safe assumption), the issuance of detailed regulations in 1968 must be considered helpful to both U.S. taxpayers and the U.S. Government. The regulations provide objective guidelines and safe haven ranges for interest on intercompany loans and rentals for tangible property. Even in situations where they do not provide precise, objective guidelines, the regulations describe IRS' philosophy on the subject and put taxpayers on notice with respect to the concepts which will underlie the IRS examination approach. Moreover, it is unlikely that a more precise definition of "arm's length" could be issued, given the complexity and diversity of business transactions.

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[1] See chapter on "Need for tax treaties" for a generalized discussion of tax treaties, including the U.S. treaty program.

The alternative methods for evaluating prices on sales of personal property are more imprecise and ambiguous in practice than is immediately apparent. All three methods highlighted in the regulations and attached summary place heavy reliance on the availability of comparative data, both from within and without the organization, to establish arm's length standards. Similarly, the regulations dealing with service charges are complex because of the requirement to include a wide range of indirect costs.

The regulations do not take into consideration the tax status of charges and allocations in the other jurisdiction and to that extent take the approach that the U.S. concepts should prevail. These questions may receive more attention in cases which are brought up for the consideration of the competent authorities under tax treaties. There have also been cases in which IRS auditors have sought to ignore the regulations and apply their own concepts of evaluating intercompany transactions.

APPENDIX CHAPTER VII

Detailed guidelines contained in Section 482 regulations

Loans and advances

Where moneys are advanced by one member of the group to another, interest will be imputed to the lender *unless an arm's length rate of interest is charged*. However, if the lender is not in the finance business, effective with loans made on or after July 1, 1981, interest at a rate in a safe haven range from at least 11 percent to not more than 13 percent will be treated as arm's length if the taxpayer does not choose (which he may) to use the true arm's length rate. If the interest does not fall in this safe haven range, an allocation at a 12 percent rate will be made by the IRS.[2] The safe haven approach does not apply where the lending affiliate borrows funds at the situs of the borrowing affiliate (i.e., generally in the same country) for relending to the borrowing affiliate, nor does it apply on post-July 1, 1981 loans or advances denominated in foreign currency.

The safe haven approach has proved useful to U.S. corporations making loans to foreign affiliates, thereby avoiding questions of what a proper arm's length rate should be in specific circumstances, and avoiding the question of whether the market rate of the lender's country or the borrower's country should be used. It is clear, however, that safe haven rates will not be acceptable to most other countries and will not form the basis of an internationally acceptable solution, as witnessed by the refusal of the OECD, in its recent report on transfer pricing, to endorse safe havens. Thus, as more countries adopt intercompany transfer pricing guidelines, it is likely that they will apply their own arm's length standards, leaving an international corporate group in the position of having to institute proceedings under the competent authority mechanism of tax treaties to avoid double taxation.

Performance of services

If a U.S. taxpayer performs marketing, managerial, administrative or technical services for the benefit of one or more affiliates, or for the joint benefit of itself and other affiliates, without charge, or at less than arm's length charge, an allocation may be made.

The regulations make a distinction between 1) services which are intended to be of direct benefit to an affiliate either in its day-to-day activities or in its overall direction, and 2) services so indirect or remote that an unrelated party would not have paid for the services. No allocation is required if the expenses are more in the nature of appraisal of the operations or financial condition of an affiliate.

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[2] The safe haven range is 6%-8% for loans outstanding prior to July 1, 1981 A 7% allocation rate will be used if the interest charged is outside the safe haven range

The rules provide that the amount of the charge for services is to be equal to the *cost* of rendering the services, unless the rendering of such services is an integral part of either party's business, in which case the intercompany charge must include a profit. The concept of cost is not as simple as it sounds since it includes not only all direct expenses identified specifically with a particular service, such as salaries and traveling expenses of employees performing the services, but also any indirect costs which relate to the direct costs.

If the services rendered by or to an affiliate are an integral part of either affiliate's business activity, the charge for the intercompany service must be made at an arm's length rate and thus include a profit element. This would also apply in cases where both affiliates are in the business of rendering similar services to unrelated parties. A profit must also be included when the services are rendered by a company whose principal activity consists of the rendering of such services to related parties.

Use of tangible property

If a U.S. taxpayer transfers possession or use of tangible property to an affiliate at no charge or at less than an arm's length charge, an allocation may be made by the IRS to reflect an arm's length lease or rental arrangement.

If either party is in the business of leasing that kind of property to unrelated parties, an arm's length rental is required. If neither company is in the leasing business, a rental based on a prescribed formula is considered to be acceptable. The formulary rental charge is based on the sum of 1) depreciation computed on a straight-line basis, 2) 3 percent of the original basis of the asset, and 3) current operating expenses, other than interest. As with interest on intercompany loans, the taxpayer retains the right to establish an arm's length rental not based on the formula, but based on marketplace criteria.

Use or transfer of intangible property

Where an interest in intangible property is transferred or made available to an affiliate for other than an arm's length consideration, the IRS is authorized, by the regulations, to make allocations reflecting an appropriate consideration.

Intangible property includes patents, trademarks, trade names, brand names and similar rights. The arm's length consideration should be in a form which would normally be adopted between unrelated parties, and could be in the form of royalties based on the transferee's output, sales, profits or any other measure, lump-sum payments or any other form, including reciprocal licensing rights. The allocation is to be effective at the time the interest in the property is transferred or made available by the developer affiliate to the transferee affiliate.

No objective guidelines, safe haven rates or a range of rates are provided by the regulations to assist in arriving at an arm's length sale consideration or royalty. As an alternative to compensating the developer of intangible property for the right to use the property once it has been developed, a group of related entities can enter into a written "cost sharing" agreement, under which the costs and risks of development can be shared by two or more affiliates in return for each being entitled to a specified interest in any property which may be produced.

Since all parties to such an agreement are sharing costs and the risks, no profit element is involved in the charges, which are simply reimbursements of expenses incurred by those parties who incur more than their allocated share thereof. This method may be particularly suitable for companies engaged in continuing research and development of many different products. It should be noted, however, that the provision for cost sharing arrangements merely shifts the problem from the valuation of intangible property to an allocation of expenses based on a determination of benefits from a corporate R&D program to companies in the group.

Sales of personal property

One of the most important areas in intercompany transfer pricing relates to prices charged for goods sold between affiliates. If goods are sold to an affiliate at less than an arm's length price, an allocation is called for. An arm's length price is the price which an unrelated party would have paid under the same circumstances for similar property. The U.S. regulations prescribe three acceptable methods of pricing goods and the circumstances under which they may be used. The three methods will be briefly described below. There is also set forth a fourth method for use if the three prescribed methods are inappropriate, considering all the facts and circumstances.

The taxpayer does not have the choice of which method to use, because it is required that the comparable uncontrolled price method be used if there are comparable uncontrolled sales. This is considered to be the most accurate estimate of an arm's length price, being based on sales to, or purchases from, unrelated parties. If it does not apply, the resale price method must be used next, because it is considered the second most accurate method, being based on outside customer sales. If certain requirements under the resale price method are not met, the taxpayer may use the cost-plus method.

Comparable uncontrolled price method

The comparable uncontrolled price is the price prevailing when buyer and seller are unrelated. This includes not only a price charged *by* a U.S. corporation to its outside customers, but also a price a U.S. corporation or any member of the group *pays* when buying from an unrelated supplier. It would also include prices on comparable sales between two other unrelated parties. Sales are comparable if the physical property and circumstances involved are the same or close enough so that ascertainable numerical adjustments can be made, e.g., for place of delivery. The price could be affected by circumstances such as quality of the product, terms of sale, intangibles involved, time of sale, level of the market and geographic market in which the sale takes place. Whether these and other differences render the price noncomparable depends on the facts and circumstances of each case.

Accordingly, sales made to unrelated customers in one country would not necessarily be comparable to sales made in another country or countries. Sales of similar products by other, unrelated companies might provide a comparable price if the other factors such as quality and intangibles are comparable. In practice, however, the terms of the sale to unrelated customers provide strong evidence of an uncontrolled price.

Resale price method

The resale price method is applicable to a manufacturer selling to a related sales company which in turn sells to on outside customer. The price of goods sold by the manufacturer affiliate to the selling affiliate is established by working back from the actual resale price charged to the customer and reducing this resale price by a markup commensurate with the functions performed by the selling subsidiary. Under this method, the taxpayer has to determine an appropriate profit margin (the markup) for the selling affiliate in order then to determine the appropriate invoice price from the manufacturer affiliate to the sales company. The markup for the selling subsidiary is the missing factor in this method and may be determined on the basis of factors both internal and external to the business.

Cost-plus method

The cost-plus method starts with the manufacturer affiliate's costs and adds an appropriate markup to arrive at its selling price. Under this method, the manufacturing costs are presumed to be determinable and the markup percentage or amount has to be established by looking first at internal and then at external trade factors. This method would normally be used if the sales company adds substantial value to a product which it has bought from the manufacturer.

July 13, 1981 STATEMENT
by the
Electronic Industries Association (EIA)

to the
Subcommittees on International Trade
and on
International Finance
of the
Senate Committees on
Finance, and on Banking,
Housing, and Urban Affairs

U.S. TRADE POLICY

EIA welcomes this opportunity to comment on the need for a comprehensive U.S. trade policy, and to contribute to the development of such a policy. Having consistently advocated the development of a more cohesive U.S. trade policy, we are encouraged by the interest shown by your Committees.

In the past, government policies on trade matters have been fragmented, uncertain and, from time to time, counterproductive. The U.S. can no longer espouse the philosophy that exportation is a privilege and a tool of foreign policy. Now, U.S. industry is engaged in an economic struggle with very able competitor nations. Our massive, cumulative trade deficit over the past four years and the continued cost of our energy dependence require that we recognize exports as a necessity.

EIA believes that the U.S. can and must handle trade problems in a more efficient and aggressive manner to support the private sector's trade and investment objectives. The complexity of world trade and investment and its ever-growing effects on U.S. institutions and society make it manifest that the development of a comprehensive, workable trade policy is not only an urgent U.S. priority but also a mutual responsibility of government and the private sector.

In pursuing the question of what a comprehensive trade policy should encompass, EIA recommends that the following six objectives should receive your careful attention:

- Strengthen the domestic economy;
- Dismantle the existing export disincentives;
- Create new export incentives;
- Reduce foreign barriers to trade;
- Safeguard against import injury;
- Centralize Government's international trade functions.

In the balance of this Statement, we will explain and justify those objectives.

STRENGTHEN THE DOMESTIC ECONOMY: The first and foremost priority for improving the U.S. position in international trade should be the strengthing of the domestic economy. A healthy domestic economy is prerequisite if U.S. firms are to become competitive again in international markets. EIA strongly supports the program for economic recovery as it has been proposed by President Reagan. In doing this, we are continuing our advocacy of (1) balancing the federal budget, (2) bringing the rate of government spending down to non-inflationary levels, (3) reducing the tax burden, (4) stimulating capital formation, and (5) easing regulatory constraints. The President's program would make significant moves on all counts.

Obviously, various segments of the public are concerned with some of the proposed budget cuts which adversely affect them. EIA has similar concerns. But the success of the President's program depends on the willingness of all Americans to subrogate their specific interests to the good of the country as a whole. We regard the President's program as one skillfully prepared for action and tailored for impact. We are confident that it will lead to a healthier domestic economy and will give U.S. companies the economic base to compete vigorously in international markets again.

We have long felt that the elements of a successful national economic program geared to the needs of the nation's private sector would provide the necessary incentive for U.S. firms to increase their investment in productivity and in research and development which is necessary to restore the competitive position that has eroded during the decade of the seventies as a result of unwise tax and regulatory programs.

With respect to research and development, EIA believes that legislation is needed to amend Section 1.861-8 of the Internal Revenue Code and we support the Wallop bill (S.1410) to remove a disincentive. Despite the potential benefits of encouraging R&D through the use of tax incentives, Section 1.861-8 tacitly discourages U.S. firms from conducting their R&D activities in the USA. If "861" is allowed to remain in force, its net effect is structurally to tax-favor the transfer of R&D activity away from the U.S., since foreign countries have no restrictions comparable to those found in "861". Regardless of any philosophical merit that Section 1.861-8 might have in the sense of "tax equity," it is definitely conducive to the exportation of both future technology and jobs.

We urge your support of the allowance for the depreciation of assets at accelerated rates. In due course, we also urge your support in terminating double taxation on distributed corporate income.

DISMANTLE THE EXPORT DISINCENTIVES: EIA advocates the immediate dismantling of the extraordinary array of disincentives to U.S. exporters which exists in statute, regulation and administrative procedure. Imposed by our own federal government, they seriously aggravate the competitivesness problems of U.S. exporters today. These disincentives include:

- Strategic and foreign policy controls on product exports, re-exports and technology transfers;

- Human Rights controls on product exports and export financing;
- Environmental controls on export financing;
- Export embargoes;
- Anti-boycott regulations;
- Foreign Corrupt Practices Act;
- Antitrust regulations;
- Limitations on the Export-Import Bank's appropriations and charter;
- Restrictions on the Overseas Private Investment Corporation's (OPIC) operating authority;
- Regulations onerously taxing American citizens working overseas;
- Add to all the foregoing: recurrent attempts to repeal DISC, "Deferral," and Foreign Tax Credit -- the only tax provisions that do boost exports.

EIA supports fully the need to amend the Foreign Corrupt Practices Act. The Chafee bill (S.708) has been introduced with this objective in mind. The present Act was drafted so ambiguously that even with special legal counsel -- which thousands of smaller U.S. exporters cannot afford -- companies remain uncertain of the law's implications. We urge the Congress to work for early amending of the present Act.

Export control regulations as presently promulgated and administered by the Commerce Department under the Export Administration Act of 1979 represent a disincentive to trade with every country in the world except Canada and are of questionable effectiveness. In other words, American exporters are penalized by our own Government in ways which are unmatched by other governments, including those of our allies, and this has caused further disintegration of U.S. competitiveness.

CREATE TRADE INCENTIVES: In addition to eliminating trade disincentives, we urge the government to enact strong incentives for U.S. trade. In this regard, EIA supports the proposed Export Trading Companies Act. Further, we urge that Federal antitrust laws be revised to permit and encourage manufacturers and distributors to form export trade associations, to utilize the export trading companies, and to develop successful international marketing networks.

We urge support of the proposed corrections of the U.S. Tax Code so that it no longer discourages: the repatriation or use of our companies' foreign earnings in the U.S., the conduct of industrial research and development in the U.S., the employment overseas of U.S. citizens by firms of U.S. ownership, and the conduct of branch operations abroad.

The role of finance in a successful trade posture cannot be underestimated. EIA urges the U.S. government to bring increased pressure to bear on other nations to eliminate subsidized government financing of exports as a trade distortion.

The Export-Import Bank of the U.S. (EXIM) exists to help U.S. companies compete effectively in world markets against foreign competitors. The budget-cutting aspect of President Reagan's Program for Economic Recovery depicts the funding of EXIM as containing an element of subsidy. We concede that an element of subsidy exists so long as the market terms at which EXIM must borrow exceed the competitive terms at which it makes loans.

The fact remains, however, that the governments of virtually all industrialized nations persist in subsidizing their export financing. Accordingly, we stress the EXIM funding should, at the very least, be maintained at the amount proposed by the President and, hopefully, increased. SEE: Exhibit-A.

There should be no doubt that export transactions financed by EXIM have a very positive effect on U.S. jobs, not only at companies consummating the transactions, but also at the broader level of their subcontractors and suppliers.

REDUCE FOREIGN TRADE BARRIERS: EIA urges the government to implement and enforce existing legislation aggressively, and to take positive action toward elimination of all foreign barriers to trade and to investment. The Agreements which issued from the Multilateral Trade Negotiations (MTN) must be vigorously enforced and violations dealt with expeditiously, by both the U.S. government and its trading partners. We oppose the present administrative practice of funding and staffing the Office of the U.S. Trade Representative and the Commerce Department only to a level which enables monitoring the conduct of this nation and its own compliance under these multilateral codes of conduct.

EIA played a unique role in the negotiations with Nippon Telegraph & Telephone Corporation (NTT) which led to the December 1980 agreement to open procurements by NTT to U.S. suppliers. The agreement was hailed as a positive step in U.S./Japanese trade relations, and an opportunity for American telecommunications manufacturers. However, while the market in Japan is large, it remains to be seen what portion of that market, if any, will be enjoyed by U.S. manufacturers.

The test of the NTT agreement is complex and relies heavily on the good faith of the Japanese. Because of the perceived heavy reliance on good faith, many are skeptical about the implementation of the agreement. EIA shares the concern that without reliable, real-time information regarding imports from and exports to Japan, neither the government nor industry will be able to quantify the effectiveness of the NTT agreement. It is absolutely essential to develop a solid statistical basis on which to judge the December 1980 NTT agreement.

Moreover, when it is reviewed in 1983, the Government Procurement Code must be broadened to include the growing -- and usually government-dominated -- sector of telecommunications. It must also expand the signatory nations' lists of their Entities whose procurement practices will conform with the code, including educational institutions and service contracts.

The size of the U.S. market for telecommunications equipment is approximately $20 billion. If foreign suppliers are able, taking advantage of the access available to our market, to capture a 25% share, they would realize $5 billion worth of business. The size of the European telecommunications market is about $8 billion, and Japan's is about $4 billion. If American exporters are able, despite our presently-limited access to those markets, to attain 25% shares there, we would realize only $3 billion worth of business.

This is by way of stressing that we must be enabled to attain a larger share of the European and Japanese markets for telecommunications equipment if we are put in the position of giving up 25% of the U.S. domestic market.

Please observe that we urge positive action toward elimination of all foreign barriers to investment, as well as to trade. By this, we ask for no more than "national treatment." American companies should be able to make investments in the countries of our trading partners; the resulting subsidiaries or affiliates should be able to do business, there, on the same basis as companies owned by nationals.

SAFEGUARD AGAINST IMPORT INJURY: A notable failure of the MTN was its inability to reach agreement on a Safeguards Code. In a world of intensifying competition among nations, EIA strongly believes we must have a workable and practicable agreement as to the circumstances which may warrant immediate action by a government when injury to a domestic industry threatens to occur, and as to the measures which such government may then properly invoke.

EIA also calls for the prompt amending of the Generalized System of Preferences (Title V, Trade Act of 1974) in that:

1. "Beneficiary" status should no longer be framed as a "preference" to be granted developing countries but, rather, as a "concession" to be made IF bilateral negotiation shows that a developing country's own conduct vis a vis the USA warrants it.
2. The bilateral negotiations should require better conduct in more respects from Advanced Developing Countries (ADCs) than from other Beneficiaries.
3. If an article imported from a Beneficiary country does contain materials or components which orginated elsewhere, then some of that NON-local content must have originated in the USA.

....or else entry of the articles from that country would not be duty-free. It would, instead, be at the ordinary MFN duty-rate.

The U.S. Generalized System of Preferences should become a System for Equitable Importation from Developing Countries.

CENTRALIZE GOVERNMENT'S INTERNATIONAL TRADE FUNCTIONS: EIA favors the further centralization of Executive Branch functions relative to international trade and investment, leading to eventual consolidation in a single Department. With a clear mandate to promote U.S. rights and opportunities in world trade, this Department could assure the timely formulation and the aggressive implementation of a comprehensive U.S. trade policy.

Moreover, we are also pondering a possible need for the Congress to centralize its responsibilities as to international trade and investment. Herein, we refer to the Committees and Subcommittees presently exercising cognizance over the various aspects of international trade and investment, each responsible for the particular aspect which falls within its scope of oversight...without, perhaps, concern for the U.S. trade position as a whole.

* * *

Finally, a major focus of a comprehensive U.S. trade policy should be the development of government-industry cooperation. Realizing that we can no longer ignore the realities of competition facing U.S. companies here and abroad, it is time for the U.S. government to call upon the private sector's expertise wherever possible. Likewise, industry resources should be used in a concerted effort to raise U.S. trade awareness. While the degree of government-industry cooperation exhibited, for example, in Japan may not be appropriate in the U.S., we can nontheless attempt to learn from the successful international trade and investment policies of our trading partners.

Business, Labor and Government must place a higher priority on world trade. The development of a U.S. trade policy and, then, of laws and regulations consistent with that policy, will contribute to the general economic health and welfare of U.S. industry and the nation as well.

EIA, a Washington-based trade association, represents some 350 American companies of all sizes, ranging from small single-product businesses to large multi-national corporations, involved in the design, manufacture and sale of electronic components, equipment and systems for governmental, industrial and consumer use.

In 1980, U.S. factory sales of electronic products exceeded $104 billion, of which over $20 billion was exported. That figure would be even higher if the electronic content in such equipment as airplanes, machine tools and other electronic-driven capital equipment were separately identified.

In the same year, the imports of electronic products were just over $13 billion, so that our sector produced a trade SURPLUS of almost $7 billion. That was in a period when the economy as a whole suffered from a $24 billion trade deficit.

Analysis of the several industries comprising the electronic sector reveals that Communications Products (plus $836 million) and Industrial Electronic Products (plus $9.8 billion) were the strongest factors in generating trade surplus, while Consumer Electronic Products (minus $3.7 billion) and Solid State Products, such as integrated circuits, (minus $223 million) suffered trade deficit.

Electronics manufacturing directly employs 1.6 million Americans. Of these jobs, at least 400,000 are tied to exports. Whether measured by production, trade or employment, "Electronics" continues to be a growth sector and one of the major, positive factors in the U.S. economy.

Electronic Industries Association
"EIA"
July 13, 1981

EXHIBIT - A

May 1981

Position of the Electronic Industries Association (EIA) on the U.S. Export-Import Bank (EXIM)

In March 1981, EIA expressed strong support of the Program for Economic Recovery as it was proposed by President Reagan to the House of Representatives and the Senate, in joint session, on February 18, 1981.

The President's Program does not fulfill the special interests of many segments of the economy, including some which are special to the electronic and other high-technology industries. However, the Program's success depends on the willingness of each segment to forego certain advantages for the sake of the common good. Under such circumstances, the electronic industries, too, are willing to accept some disadvantages.

Among those disadvantages, because over 20% of our domestic production is exported, is the prospect of limitation on the funding of EXIM. The budget-cutting aspect of the President's Program depicts the funding of EXIM as containing an element of subsidy. So long as the market terms at which EXIM must borrow exceed the competitive terms at which it must lend, we concede that an element of subsidy exists. However, the fact remains that the governments of virtually all industrialized nations persist in subsidizing their export financing.

The reason for EXIM's existence is to help U.S. companies compete effectively in world markets against foreign competitors. So long as foreign governments continue to assist their companies by providing subsidized export financing, it would be counterproductive for the U.S. Government to require EXIM to operate at market terms. Export transactions financed by EXIM have a very positive effect on U.S. jobs, not only at companies consummating the transactions, but also at the broader level of their subcontractors and suppliers.

Accordingly, EXIM funding should, at least, be maintained at the amount proposed by the President and, hopefully, increased.

EXIM funding should be decreased only as a quid pro quo for the elimination of subsidy by foreign governments.

The United States must be able to bring increased pressure to bear on other nations toward the multilateral elimination of governmental subsidy from the financing of export transactions...on grounds that it constitutes a trade distortion. The United States must, in such negotiations, be able to bargain from strength, not weakness.

Oversight Hearings on U.S. Trade Policy

Before the Senate Finance Subcommittee on International Trade and the Senate Banking Subcommittee on International Finance and Monetary Policy

STATEMENT
OF
ROBERT J. BLINKEN, CHAIRMAN
UNITED STATES FASTENER MANUFACTURING GROUP

July 13, 1981

These trade policy oversight hearings are especially timely in light of the growing awareness that the security of the United States is in large measure dependent upon the capacity of its industrial base to mobilize during a period of national emergency. At the present time, however, a number of key industries do not have the capacity to respond adequately to such an eventuality. In many cases the principal cause for this condition is import displacement.[1] This includes the American industrial fastener industry which is struggling to survive in the face of a 50% import penetration rate for nuts, bolts and large screws.

The stark fact is this: If a crisis arose today, involving a national mobilization and conventional war, the domestic industry could not produce enough metal fasteners to meet defense and essential civilian requirements. Because of curtailed access to foreign supplies, the United States would be confronted with severe shortages, projected as follows:

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[1] The Defense Industrial Base Panel of the House Armed Services Committee has reported that "import penetration into certain industrial sectors, such as machine tools, industrial fasteners and semiconductor devices, suggest an unacceptable dependency on foreign sources for key elements of defense production". "The Ailing Defense Industrial Base: Unready for Crisis" (Dec. 31, 1980, at p. 16).

Supply Shortfall[2]

- o 1981 mobilization --- 1.42 to 1.56 billion lbs. (26% to 28%)
- o 1982 (1st war year) --- 2.66 to 3.38 billion lbs. (41% to 52%)

Since metal fasteners are indispensable for virtually every kind of manufacturing and construction in our economy, the effect of such shortages during a national emergency would be disastrous. Major industrial activities would have to cease abruptly.

The industrial fastener situation has enormous implications for the trade policy and the national security interests of the United States. It dramatizes a dangerous blind spot in United States trade policy which the Congress and the Executive Branch must somehow correct if an adequate level of industrial preparedness is to be achieved and maintained.

Throughout most of its industrial history the United States has been self-sufficient in the production of industrial fasteners. This enabled the domestic fastener industry to meet the greatly expanded requirements of the United States and its allies during World War II. In the 1960s, however, the domestic industry began to feel strong import pressures, particularly from Japan where the government had embarked on a major subsidy program to foster the export competitiveness of its fastener industry.[3] The ensuing onslaught weakened the U.S. industry substantially, thereby increasing its vulnerability to imports.

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[2] These figures are 1977 Federal Preparedness Agency projections adjusted for 1980 data from the U.S. International Trade Commission. See Appendices I and II.

[3] See "How Japan Captured a Major Share of the U.S. Fastener Market", Appendix III.

One of the hardest-hit segments of the U.S. industry has been nut, bolt and large screw production. Between 1960 and 1980 the quantity of imports of these products increased by more than 600%. In 1960 the import market share was roughly 6%. By 1980 imports had captured about 50% of the U.S. market.[4/]

Federal Preparedness Agency Study (December, 1977)

Recognizing the critical nature of industrial fasteners and the import erosion of the domestic industry's production capacity, the Defense Department expressed its concern to the Federal Preparedness Agency (FPA) in January, 1976. The FPA accordingly selected the industrial fastener industry as the subject of its first study of wartime product supply adequacy. That study, entitled "Metal Fasteners: A Study of Projected Requirements and Supplies in a National Emergency", was completed in December, 1977.

The FPA study assumed a 1981 mobilization, followed by three years of conventional war. Under these circumstances, the study projected a shortfall in metal fastener supplies, ranging from 13% to 17% of defense and essential civilian requirements, during the mobilization year. The projected shortage for the first war year was between 25% and 41% of requirements.

[4/] See Appendix IV.

Loss of Production Capacity Since 1977

Subsequent events have shown that even the dire FPA predictions were optimistic. The reason is that the FPA calculations of domestic production were based on an assumed 5% decline in domestic production capacity between 1977 and 1981. In fact, the International Trade Commission's annual survey of domestic nuts, bolts and large screws shows that the industrial fastener industry's capacity to produce these products has actually declined by 28% since 1977.[5/] This means that the supply shortfall under a 1981 mobilization and three-year, conventional war scenario would be considerably worse than originally predicted.

Effects of Fastener Production Loss on Industrial Readiness

A severe shortfall in industrial fastener supplies during a period of emergency would bring industrial production to a standstill in many vital areas of our economy. The critical nature of such fasteners has been described by the Defense Department in the following terms:

> "The industrial fastener industry is one of the basic industries supporting civilian and defense production requirments. Everything is held together by some kind of fastener. An automobile uses 35,000, a Boeing 747 uses 500,000, a machine tool uses about 1700 and a C5A contains 2,306,400."[6/]

[5/] USITC Publication 1134, March, 1981.

[6/] Letter dated January 27, 1976, from Deputy Assistant Secretary of Defense (Materiel Acquisition) to Director, FPA.

In a study based on the FPA report, the highly-respected Data Resources, Inc., measured the impact of a wartime fastener shortage on the economy as a whole.[7] The results, assuming a shortfall of only 10%, were as startling as they were grim:

> "The effects are severe. The results indicate that even a small shortfall of 10% would produce either unacceptably large cutbacks in personal consumption or capacity 'lossage' in the general economy of up to 100 times (in dollar terms) the size of an initial shortage. Hence a $200 million shortfall could result in an economy-wide capacity loss of up to $20 billion."

The alarming findings of the FPA study prompted the Director of that agency to advise the White House, in a letter to Robert Strauss, dated February 3, 1978, that "because of deteriorating domestic capabilities large and increased levels of imports [of industrial fasteners] would be required in the event of a conventional war".[8] The letter concluded:

> "I do not feel it prudent for national policy to allow such import dependency". [Emphasis added]

It is important to understand, in that connection, that the Soviet Union is entirely self-sufficient with respect to nuts, bolts and screws.[9]

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[7] "Nuts, Bolts and Large Screws: The Impact of Shortages in a National Emergency", May 10, 1978.

[8] The letter is reproduced in Appendix V.

[9] Testimony of Congressman John Anderson, citing U.S. intelligence sources, Hearing before Subcommittee on International Trade, Senate Finance Committee, 95th Cong., 2d Sess., April 4, 1978.

President's Denial of Import Relief (February, 1978)

The FPA letter was sent at a time when the President was called upon to decide whether to grant temporary relief to the domestic industry with respect to imports of nuts, bolts and large screws, following a determination by the International Trade Commission under section 201 of the Trade Act of 1974 that the domestic industry was seriously injured by such imports. Despite the FPA warning and despite the serious injury determination of the International Trade Commission and its recommendation for a temporary tariff increase, President Carter denied import relief to this industry in February, 1978.[10]

National Security Investigation of Fastener Imports (February-October, 1978)

In an apparent attempt to diffuse adverse political reaction to his denial of import relief, the President instructed the Treasury Department to conduct a national security investigation under section 232 of the Trade Expansion Act of 1962. The outcome of the Treasury investigation seems to substantiate the view that this action did not reflect a serious effort to deal with the national security question raised by the FPA study.

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[10] There was a bitter struggle in Congress to override the President's decision. The House Ways and Means Committee adopted a resolution calling for a new investigation which was initiated by the International Trade Commission in August, 1978. In November, 1978, the Commission again recommended import relief for a 5-year period (USITC Publication 924, TA-201-37). In January, 1979, President Carter granted import relief at a modest level for a 3-year period. On June 30, 1981, the industry, including the steelworker, machinist, and auto worker unions, filed a petition for a 3-year extension of the import relief.

Although the Treasury Department had responsibility for section 232 at that time, it had neither an organizational structure nor any qualified personnel to carry out that function. Because the Commerce Department and the Defense Department had long-established expertise in the areas of industrial and defense preparedness, they were asked to participate in the investigation.

A. Commerce Department Position

The position of the Commerce Department was expressed in a September 13, 1978, letter to the Treasury Department from the Assistant Secretary of Commerce for Industry and Trade, as follows:

> "Since we have concluded from our review that a serious 'threat to impair the national security' exists as the result of the extensive imports of bolts, nuts and large screws, we want to supplement our earlier report with the recommendation that action be taken, as prescribed in section 232 of The Trade Expansion Act of 1962, as amended, so as to alleviate this threat."

B. Defense Department Position

Similarly, the Defense Department in an October 3, 1978, letter to the Treasury Department from the Deputy Under Secretary of Defense (Acquisition Policy), came to the following conclusion:

> "The increasing trend in imports of nuts, bolts and large screws constitutes a threat to the national security of the United States to the degree that American industry will be able to supply only 42%

> of the total national security demands in a 1981 national emergency, even after a one-year mobilization build-up of capability. Domestic producers will not be capable of meeting even the small direct defense demands for nuts during the war years following a 1981 mobilization."

C. Treasury Department Determination

Against that compelling background the Treasury Department, nevertheless, determined that industrial fastener imports did not threaten to impair the national security interests of the United States. The principal reason for that conclusion was explained in Treasury Secretary Blumenthal's October 18, 1978, memorandum to the President, as follows:

> "The only scenario for which a threat to the national security has been articulated is based on World War II - type of conflict. Although wartime scenarios are not within our expertise, we think the likelihood of this scenario is debatable." [Emphasis added]

In short, the informed judgments of the Departments of Commerce and Defense, as well as the Federal Preparedness Agency (now the Federal Emergency Management Agency), were effectively ignored by the Treasury Department - an agency which had no expertise or background in matters of industrial mobilization or strategic planning and which openly admitted it.[11] Such an exquisite display of irrationality might be laughable were it not for the grave national security implications.

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[11] Responsibility for section 232 was subsequently transferred to the U.S. Department of Commerce.

Administration's Views on Industrial Preparedness

The Reagan Administration has stressed the need for an adequate industrial mobilization base in the interest of national security. Secretary of Defense Weinberger expressed the Administration's views on this point in his May 5, 1981, speech in Chicago:

> "Over the years, we have neglected our capacity to mobilize our industry for defense. ... We cannot hope, nor would we want to match our adversaries in ground forces during peace. Hence, the readiness with which we could mobilize our industrial potential serves as our countervailing reserve of military strength." [Emphasis added]

Secretary Weinberger repeated this theme in his June 17, 1981, speech in New York, as follows:

> "We also must develop a capability to expand defense production massively in the event of an all-out emergency. ... And we are urgently making preparations for emergency mobilization of industry. The ability of American industry to respond quickly to a defense emergency is highly unsatisfactory today. ... Yet, all these preparations for non-nuclear warfare are only half-measures, ... unless we improve our industrial capacity to expand defense production in wartime." [Emphasis added]

We agree emphatically with that assessment and with the Administration's policy response to it, as reported in the New York Times of June 28, 1981:

> "While expanding the strategic nuclear deterrent, the Administration will emphasize preparations for a long conventional war."

* * * * *

> "The Administration will give priority to rebuilding the industrial base ..."

Administration's Statement on U.S. Trade Policy

On the first day of these hearings United States Trade Representative, William Brock, presented the Administration's Statement on U.S. Trade Policy, or so-called Trade Policy "White Paper". That statement contained a discussion of the import adjustment problems of U.S. industries, and the Administration's approach to those problems, including the following:

> "Our policies toward the adjustment will take into account the fact that the economic vitality of certain sectors of our domestic economy is clearly essential to national security." [p.5, Emphasis added]

We applaud the Administration's recognition of the importance of the national security factor in deciding import adjustment questions, including those that arise under sections 201 and 203 of the Trade Act of 1974. Such a policy is eminently sensible and clearly needed, as the prior industrial fastener cases demonstrate.

It now remains to be seen how and to what extent that policy will be implemented by the new Administration.

Need For Congressional Review

Because the Constitution gives the Legislative Branch preeminent power to regulate foreign commerce, we urge a thorough Congressional review of our trade policy, as it relates to imports and national security interests. It is apparent that this subject has not been given adequate attention for many years. We would hope that such a review would result in comprehensive legislation on the subject, such as Congress has enacted in the Export Administration Act, which provides a clear policy and mechanism for controlling exports under circumstances that could prejudice the security interests of the United States. In short, export policy and national security policy have been largely integrated after receiving careful consideration by the Congress. A similar process, we submit, is needed where import policy is concerned.

Robert J. Blinken is Chairman of the Board of the Mite Corporation. The United States Fastener Manufacturing Group is an *ad hoc* organization with 16 company members which account for a major portion of the nuts, bolts and large screws produced in the United States.

Selected Summary of Federal Preparedness Agency's
Supply Shortfall Projections For Industrial Fasteners:

Year	Requirements (Millions of lbs)	Supply (Millions of lbs)			Shortfall (Millions of lbs)	Ratio (Shortfall/ Requirements)
		Domestic Production	Available Imports	Total		
1981 (Mobilization)	5521	2907-2665[1]	1886-1934[2]	4793-4599	728-922	13.2 - 16.7%
1982 (1st war year)	6492	4289-3150[1]	555-710[3]	4844-3860	1648-2632	25.4 - 40.5%

[1] Assumes a 5% decline in production capacity for industrial fasteners from 1977 to 1981.

[2] Assumes increase in imports from Canada, but no increase in imports from other sources.

[3] Assumes cutoff of imports from Japan and Europe and reduced imports from other sources, except Canada.

ource: Federal Preparedness Agency, "Metal Fasteners: A Study of Projected Requirements and Supplies In a National Emergency", December, 1977.

Supply Shortfall Projections for Industrial Fasteners: FPA Projections Updated With 1980 USITC Production Capacity Data

Year	Requirements (Millions of lbs)	Supply (Millions of lbs)			Shortfall (Millions of lbs)	Ratio (Shortfall/ Requirements)
		Domestic Production	Available Imports	Total		
1981 (mobilization)	5521	2218-2033	1886-1934	4104-3967	1417-1554	25.7 - 28.1%
1982 (1st war year)	6492	3273-2403	555-710	3828-3113	2664-3379	41.0 - 52.0%

Note: Domestic production figures of the Federal Preparedness Agency (FPA) study on industrial fasteners are adjusted to reflect the 28.7% decline in production capacity for nuts, bolts and large screws (1977-1980) reported by the U.S. International Trade Commission (USITC Publication 1134, March, 1981). The adjustment assumes the capacity decline is applicable to all industrial fasteners.

How Japan Captured a Major Share of the U.S. Fastener Market

The following, offered in conjunction with John Lohrman's statement, briefly describes Japan's government/industry program to promote the export competitiveness of its fastener industry in the 1960s. It was prepared by Peter Buck Feller, of the Washington, D.C. law firm of McClure & Trotter, who represent USFMG.

About 80% of Japanese fastener exports are sold to customers in the United States. Since 1964, imports of nuts, bolts, and cap screws from Japan began to "take off." That growth was, and is, the result of concerted action by the Japanese fastener industry and the government of Japan. The penetration of the U.S. fastener market was the primary objective of a Japanese master plan apparently adopted in the early 1960s. That plan called for the "hothouse" development or "rationalization" of the Japanese fastener industry by means of government-supervised standardization, government-assisted quality control, government-funded acquisition of advanced production machinery, and a whole variety of governmental subsidies and incentives to promote the modernization and export competitiveness of the industry. That blueprint was described in a publication of the Fasteners Institute of Japan, entitled "Industrial Fasteners in Japan" (1964), as follows:

> The government, under Mechanical Industry Development Temporary Measure Law, has set up a plan to install, in 1964, new machines to expedite the progress of fasteners industry. Part of funds required for the installation of new machines will be financed by the government." The undated publication was issued in 1964.

This document sets forth officially-ordained export target figures for bolts and nuts for the period April 1964 to March 1965. The export target figures are prefaced by the following statement:

> "The liberalization of foreign trade, set out by the Japanese government helped by its policy for encouragement of exports, gives way for increased outflow of fasteners products to foreign countries."

This document goes on to specify that, under the government's plan to achieve its export targets, a total of 902 machines were to be installed in 1964.

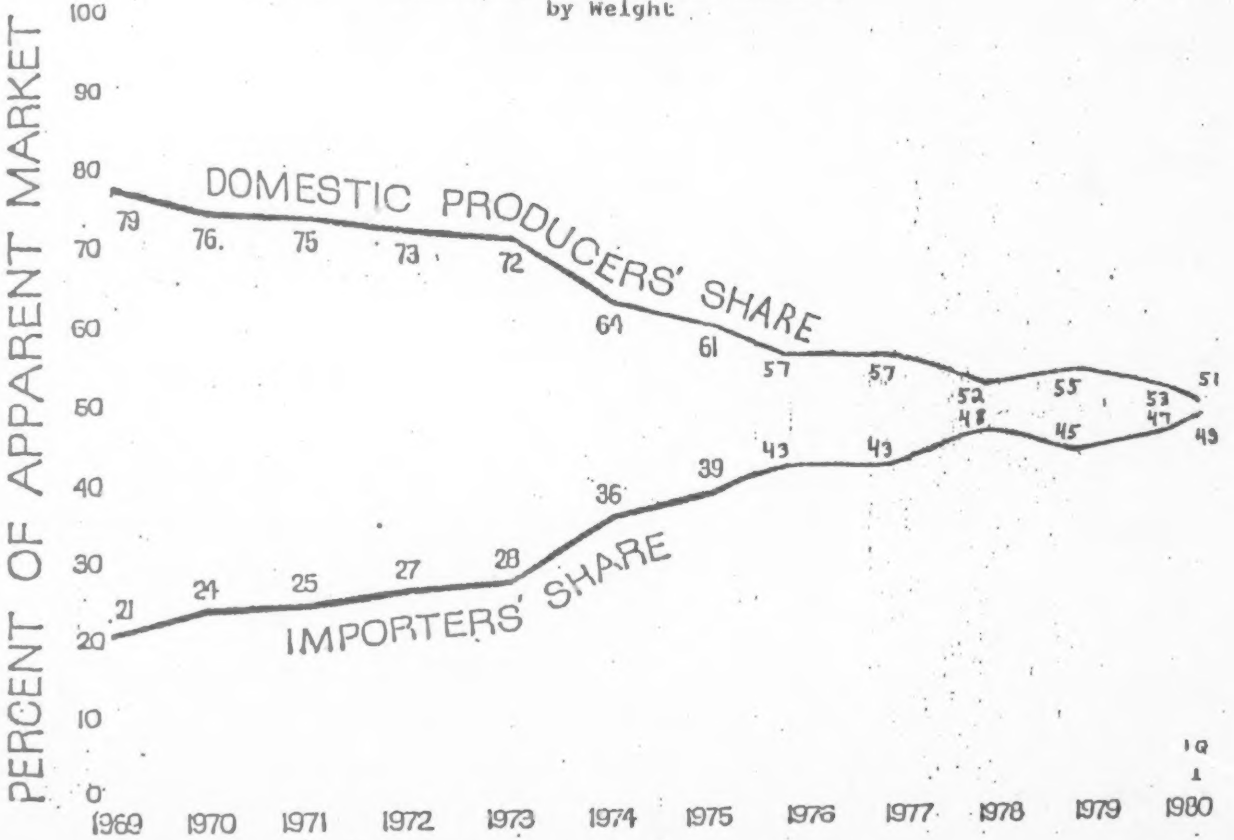
The breakdown of that total was as follows:

Number	*Name*
482	*Metal machine tools* (including centerless grinders, high-speed lathes, thread rolling machines, and automatic nut tapping machines)
285	*Metal machine tools other than the above* (including cold headers, hot headers, automatic nut presses, cold nut formers, and trimming machines)
65	*Testing equipment* (including torsion testing machines, length measuring machines, length measuring machines, screw threading testing microscopes, fluorescent flow detector and magnaflux testing machines, and metal composition analyzing apparatus)
70	*Other machines* (including cold hopping presses, shot blasting and peening machines, and heat treatment facilities)

The effect of the acquisition and installation of the new machinery described above was both immediate and dramatic. United States imports of Japanese nuts, of iron or steel, jumped by 100% in 1965. Bolt imports from Japan rose by 33%; and cap screw imports from Japan rose by 72% in that year. Implementation of the Japanese master plan produced a rise of some 1,092% in bolt exports to the United States between 1964 and 1974. During the same period, Japanese nut exports to the United States rose by 2,479%; while Japanese cap screw exports to the United States rose by 4,070%.

DOMESTIC PRODUCERS' and IMPORTERS' SHARE of APPARENT U.S. MARKET

for Bolts, Large Screws and Nuts
by Weight



[Letter from Federal Preparedness Agency to Ambassador Strauss, dated Feb. 3, 1978]

HON. ROBERT S. STRAUSS,
Special Representative for Trade Negotiations,
Washington, D.C.

DEAR MR. STRAUSS: I appreciate your solicitation of our views as to whether or not import relief should be granted to certain products of the domestic metal fastener industry. My views reflect national security rather than strictly economic considerations.

My staff has conducted a study to determine, as nearly as possible, the adequacy of wartime metal fastener supplies. The study concludes that because of deteriorating domestic capabilities large and increased levels of imports would be required in the event of a conventional war. I do not feel it prudent for national policy to allow such import dependency.

I believe that an investigation under section 232 of the Trade Expansion Act of 1962 should be undertaken to reach a definitive national security finding. However, such an investigation is time consuming and the domestic industry's position in the "standards" metal fastener market is deteriorating rapidly. I therefore urge that consideration be given to providing temporary tariff relief pending completion of a section 232 investigation.

RONALD ROYAL,
Acting Director.

STATEMENT OF
PAUL E. JOHNSON
VICE PRESIDENT, SPECIAL MARKETS
INTERNATIONAL HARVESTER COMPANY
REGARDING
TRADE RELATIONS WITH HUNGARY, ROMANIA AND CHINA

International Harvester Company appreciates the opportunity to express its views on continuation of the waivers applicable to trade with the Hungarian People's Republic, the Socialist Republic of Romania, and the People's Republic of China. International Harvester has a long history of trade with both Eastern Europe and China--our predecessor company began trade with Eastern Europe in 1880 and our trade with China goes back to the turn of this century.

Today, in addition to sales of equipment manufactured in the West, IH has cooperation agreements in manufacturing with enterprises in Poland and Hungary. In light of these successful relationships, we are pursuing additional opportunities in Eastern Europe and China.

Since the U.S. granted Hungary most-favored-nation (MFN) status, Hungarian products have been able to find greater access to the U.S. market. We have no doubt that continuation of MFN status for Hungary will facilitate the growth of International Harvester's trade with Hungary.

International Harvester currently sells to Hungary complete machines, service parts and components to complement local technology, and provides technical assistance in the form of licensed technology. In 1981, we expect these sales to total approximately $4 million. IH purchases from Hungary tandem drive axles for heavy-duty truck tractors. Such purchases would normally be at a level of $10 million annually, but they are currently running at a much lower level due to the depressed state of the U.S. truck market. It is important to emphasize that the IH exports of U.S. goods and technology mentioned above could not be realized unless the company were also purchasing axles from Hungary.

Over the last 10 years, Hungary has been developing a system of intensive cultivation and harvesting of grain crops that is on the leading edge of world technology and is a model for all of Eastern Europe. U.S. partners have assisted the Hungarians in this program and since the granting of MFN treatment by the U.S. and Hungary to each other's products, International Harvester has been designated by Hungary as the prime supplier of equipment for this program. As a result, IH is now moving to take advantage of this growing opportunity to sell large four-wheel-drive tractors and companion implements throughout Hungary. Hungary has thus become a major export market for our agricultural equipment manufactured in the U.S. (an estimated annual sales of $12 million annually)--a market we believe will continue to grow under the encouraging umbrella of MFN.

International Harvester has been particularly pleased with its business association with the Hungarian enterprise, RABA, which has proven to be a reliable supplier of quality axles to our Fort Wayne, Indiana, heavy-duty truck plant. RABA has adapted rapidly to the technology we have transferred to it in both the truck and agricultural equipment areas. Our association with RABA has always been in strict accordance with the highest standards of business ethics from the moral, financial, technical, and commercial points of view.

As is the case with Hungary, enterprises in Romania need convertible currency generated by sales to the U.S. if they are to be able to, in turn, increase their purchases of U.S. products. International Harvester believes continuation of MFN status for Romanian products will facilitate the growth of IH's trade with Romania, where we are always pursuing additional opportunities for mutually beneficial trade.

In China, International Harvester has moved to take advantage of the opportunities for major equipment sales opened up by approval of the U.S.-China bilateral trade agreement in 1980. We believe China will be a significant market for the products that International Harvester makes--medium- and heavy-duty trucks, agricultural machinery and construction equipment. China's modernization plans, even though less ambitious now than when originally formulated, put a high priority on developing agriculture, the transportation system, and the extraction of natural resources. The needs of these sectors would provide major export opportunities for U.S.-based suppliers of capital equipment. China's interest in U.S. equipment has been demonstrated by major orders for International Harvester forestry equipment, agricultural machinery, and large oil-field trucks.

Finally, I would like to emphasize our belief that maintenance of normal trading relations with China and Eastern Europe, and American industry's interaction with government officials and leaders in those countries, have tended to break down barriers of suspicion and mistrust, helping in some way to move the world closer to peace.

For these reasons, we heartily support extension of the waivers of the Jackson/Vanik Amendment and the resulting reaffirmation of the MFN status for Hungary, Romania, and China.

STATEMENT OF THE
SUN DIAMOND GROWERS OF CALIFORNIA

Sun Diamond Growers of California, markets Sun Maid raisins, Diamond walnuts and Sunsweet prunes, each of which is a major California crop. Sun Diamond sells approximately one-third of the crops in export by direct sale, using a broker network. Sales are made in more than 100 countries, but the principal markets are in Northern Europe and Japan. This year's export sales of raisins will be almost $50 million, of walnuts $25 million and of prunes about $30 million.

The best help we have among the government agencies, perhaps surprisingly, is the Department of Agriculture's Foreign Agriculture Service (F.A.S.).

First, they maintain representatives in foreign embassies who serve us directly in foreign trade. Recently, these positions were upgraded from "Agricultural Attache" to "Agricultural Counselor" positions. Everywhere we go, in the capitals of Europe and the world, these Agricultural Counselors welcome us and we have an effective team effort to expand sales. If necessary, they provide introductions to foreign government officials or to potential customers. More importantly, they provide essential marketing data for each nation. If the nation is a competitive producer, then they maintain data on the trend of crop size and quality. If it is a consumer nation, then they supply the finest marketing intelligence. This provides the framework for our sales activities.

Secondly, the F.A.S. has certain funds available for export market development. This may be for research on foreign markets, for commodity industry promotion overseas, or for specific export incentive programs. This export development program is particularly effective because it is administered effectively. They require participation from exporters with matching funds and require performance in terms of specific sales goals.

It is hard to find another government agency where there is such a clear benefit for the U.S. taxpayer's dollar. Clearly, this program has contributed to the great increase in agricultural exports in recent years. It is disappointing that the limited funds available for this program have not increased in proportion with increasing exports, and have not even kept up with inflation.

The State Department's performance contrasts sharply with this solid, practical and worthwhile support for our exports by the Foreign Agriculture Service. The State Department has been ineffective in helping establish fair competition for U.S. products in foreign countries. They appear unsympathetic to us in contrast with the Agricultural Counselors of the Foreign Agriculture Service. Increasing exports is a lower priority to the State Department than other diplomatic issues such as national security and human rights.

The second best help among government agencies, after the F.A.S., is the United States Trade Representative's office (USTR). Overall, the USTR has been aggressive, but inhibited by these same other government priorities. It has not been as successful as we had hoped, but still an effective participant with us in seeking fair competition abroad. We have recently benefited materially from USTR efforts to reduce barriers to exports of both prunes and raisins to Korea.

We live in a world of increasing tariff and nontariff barriers against our commodities. For thirty years, we have seen the growth of regional economic communities, and the growth of national buying cartels. In other words, amalgamations of buyers, or of sellers, acting in concert. Long term, there is an increasing concentration among the competitive participants in our markets. This trend has been reversed in the United States, with expansion of antitrust efforts and enactment of the Foreign

Corrupt Practices Act. For example, there are eighteen independent raisin packers in California who aggressively compete in each foreign market, but are confronted by national programs from raisin producers in the raisin producing coutnries of Greece, Turkey, Australia and others. In addition, our government has recently undermined our ability to even gain market intelligence by its prohibiiton of further participation in the International Sultana Conference. This prohibition places our growers at a severe disadvantage in world markets.

New national entrants have been created by World Bank financing of agricultural projects. These projects are evident particularly in less developed countries such as Afghanistan and India. Afghanistan has developed an important export capability in raisins. These agricultural developments become competitors for our traditional export markets. And they compete as nations against the independent U.S. companies exporting raisins, walnuts or prunes.

This increasing concentration of foreign trade, and the lack of a coordinated U.S. program, means that we are increasingly unable to participate in many markets.

As an example, Mexico used to be a traditional Sun Maid raisin market. Currently we cannot export a pound of raisins into Mexico, but the Mexican raisin industry sells in the United States, suffering only a modest U.S. duty.

The European Community has effective barriers against U.S. raisins and table grapes. But, European Community wine enters the U.S with few restrictions. The Thompson seedless grape variety, used for raisins and table grapes, is also a principal grape variety used in wine.

France, the world's second largest prune producer, is subsidizing prune exports to third markets, which we believe to be in violation of European Community agreements.

Within the last month, Greece has begun selling raisins in Europe at $1400 per metric ton, in comparison to Sun Maid's $2,200, which reflects our rock bottom cash costs. Greece entered the Economic Community last January. We understand that the Greek government is subsidizing the raisin farmer, offering eight-month interest free loans to raisin packers, and subsidizing raisin exporters as well. We cannot successfully compete with this current $800 advantage for Greek raisins. We can accept a $200 disadvantage because of our superior cleaning and quality and sanitation, but the extra $600 makes us noncompetitive.

In addition to the subsidy problems, there are high outright trade barriers such as 100% duties in the Philippines and Taiwan, or 85% duties common in Latin America. There are also hidden barriers such as handler or exporter credits which have the same effect of blocking U.S. export sales.

These are our immediate problems: How to match this unfair competition? We would like to see the U.S. government be as supportive of exports as governments of our foreign competitors are. Foremost among the many options to be considered, however, should be your continued support for the USDA Foreign Agriculture Service programs and for the United States Trade Representative's office.

VERONICA A. HAGGART
Attorney at Law
Suite 705
1101 17th Street, N.W.
Washington, D.C. 20036

July 22, 1981

Committee on Finance
Subcommittee on International Trade
U.S. Senate
2227 DSOB
Washington, D.C. 20510

Re: Oversight Hearings on U.S. Trade Policy

To Whom It May Concern:

Enclosed please find copies of statements from the California Almond Growers Exchange, the California-Arizona Citrus League, the National Soybean Processors Association, the California Avocado Commission and the Cling Peach Advisory Board which are being submitted in response to the notice of oversight hearings on U.S. trade policy. It is requested that these statements be made a part of the record of the hearings.

Very truly yours,

Veronica A Haggart

Veronica A. Haggart

VAH/dlt
Enclosures

American Farm Bureau Federation

WASHINGTON OFFICE
425 13TH STREET, N.W.
WASHINGTON, D.C. 20004
AREA CODE 202 - 637 - 0500

CABLE ADDRESS AMFARMBUR

July 21, 1981

Honorable John C. Danforth, Chairman
Subcommittee on International Trade
Committee on Finance
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Danforth:

The American Farm Bureau Federation, representing over 3 million member families, offers the following comments on the trade policy points to which you recently invited response.

Access to Foreign Markets

The Farm Bureau realizes that the economic health of the entire world depends upon mutually beneficial trade among nations. We urge that coordinated United States efforts to strengthen monetary and trade policies be continued and increased in order to reduce trade barriers among nations.

Farm Bureau strongly supported the Geneva trade talks and supports the implementation of the results of those talks.

Last year agricultural exports amounted to over 40 billion dollars worth of commodities and farm products. American farmers and ranchers believe exports are essential to an efficient American agriculture and to improved net farm income. Access to foreign markets is something which must be sought on a continuing basis by the responsible government officials. Although some progress was made during the Geneva trade talks, there remain too many tariff and non-tariff barriers affecting U.S. agricultural products. This is true not only for developing countries but remains a problem in such important markets as Japan and the European Community.

Enhanced Export Incentives

Government programs and policies should be directed toward improved trade between nations. Our tax laws and policies concerning how U.S. businessmen deal with foreign importers, including buying agencies in the centrally planned economy countries, should be thoroughly analyzed; and, where possible, changes should be made which will contribute to increased trade. Businessmen, including farmer-owned cooperatives which engage in export activities, need to know what the trading conditions and rules are and what to expect from government policies and programs relating to trade. Farm Bureau has supported legislation which would encourage and permit the organizations of trading companies. We believe that such legislation will prove to be an incentive, especially for small firms and farmer-owned cooperatives which could benefit from the services provided by trading companies.

Exports Credit Subsidies

Farm Bureau opposes subsidized exports. We have strongly supported legislation for a revolving fund for CCC credits which are not subsidized.

We encourage official discussions with other nations in order to discourage the use of subsidized credits which provide a competitive advantage to their exports over those of the U.S. We hope that a credit war can be avoided through diplomatic efforts. We have been especially concerned regarding both subsidized export commodities and subsidized export credits by certain European countries.

Export Controls and Embargo

Farm Bureau opposes embargoes and moratoriums on agricultural exports. They inhibit food production, antagonize foreign customers, contribute to a United States balance-of-payment deficit, faster inflation and reduce U.S. ability to purchase needed products such as petroleum. We oppose any export restraints by the government on private groups except where national security requires such action.

Any embargo should apply to all trade, technology and exchanges, except those needed to maintain diplomatic relations.

Farm Bureau strongly opposed the embargo which was imposed in January, 1980 against the Soviet Union. That embargo was not only detrimental to farm income, it also caused a shift in trade patterns which may never be corrected. In addition, it was ineffective in that it hurt the United States farmers more than it did the Soviet Union, and was unfair since it put the main burden of the embargo on the backs of only one group, farmers.

Farm Bureau believes that any future embargoes imposed by the government should require the consent of the Congress, except in time of war.

Export Competitiveness

Farm Bureau believes that export policies should avoid subsidies on commodities and products, or export credits and should be directed at sharpening competitiveness by elimination of any unnecessary regulations and restrictions which affect our exports.

Import Relief

Regarding import relief and trade adjustment, Farm Bureau does not believe that inefficient enterprises should be protected except as required by law. Where problems arise concerning imports, such as unfair import practices, they are best handled by the United States International Trade Commission which recommends remedies to the President. Farm Bureau recently opposed any restrictions on automobile imports. That opposition revolved around two points: (1) It was felt that mandatory restraints on automobile imports could invite retaliation on U.S. farm commodities being exported to Japan, and (2) United States automobile manufacturing can compete with Japanese cars if they will produce a gas efficient, quality product.

Investment Abroad

Farm Bureau believes that the United States Government has a legitimate role in seeking a solution to barriers and restrictions on investment by United States firms abroad. Many countries, including our Canadian neighbors, enjoy investment opportunities in the United States but have in recent years become increasingly restrictive regarding United States investment within their countries.

Our government should, through diplomatic channels, work to make investment a two-way street.

While considerable effort has been directed toward the reduction of barriers to trade regarding commodities and products, very little has been done regarding barriers to trade in services. Attention to this latter area is long over due.

Mr. Chairman, Farm Bureau appreciates the opportunity to comment on these trade policy points. We will appreciate consideration of our views and request this be made a part of the hearing record.

Sincerely,

Vernie Glasson, Director
National Affairs Division

cc: Subcommittee Members

BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
SUBCOMMITTEE ON INTERNATIONAL TRADE

AND

BEFORE THE
COMMITTEE ON BANKING
UNITED STATES SENATE
SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY

Oversight Hearings on U.S. Trade Policy

STATEMENT OF THE CALIFORNIA AVOCADO COMMISSION

INTRODUCTION

The California Avocado Commission is pleased to have this opportunity to present our views on the importance of a comprehensive trade policy as it relates to U.S. agricultural exports and specifically to exports of California avocados.

The California Avocado Commission is organized under the laws of the State of California and represents all California avocado growers. The Commission's membership is comprised of approximately 7,200 growers holding a total of 55,000 acres. In the most recently completed crop year, November 1979 to Ocotber 1980, we produced 148 million pounds of avocados, worth a record $118 million. This represents 80% of U.S. production of avocados. We expect total tonnage in 1981 to be up significantly from the 1979-80 record value. As a matter of fact, our estimate for this current crop year is 490 million pounds-fully three times as much fruit as was produced last year.

In 1978, we exported 13 million pounds of avocados, in 1979, 17 million pounds, and in 1980, 22.5 million pounds, or about 15% of our total production. We are optimistic about our future as an export industry. This optimism is underscored by exports in the first quarter of 1981 of 13.5 million pounds of avocados.

This increase in avocado exports will expand as well as diversify our industry, while helping to improve the United States' trade posture, a vital issue with which these Committees are properly concerned.

EXPORT MARKET DEVELOPMENT

We feel aggressive export market development by the public and private sectors working together is one of the best ways to make immediate progress in improving the United States' balance of payments. We applaud the emphasis that Secretary

Block has placed on the expansion of overseas markets for U.S. agricultural exports.

Where the California avocado industry has most aggessively developed markets, Japan and Europe, we have made great strides in the last few years. With respect to Japan, the Toyko Round of the Multilateral Trade Negotiations achieved tariff reductions that made it profitable for us to begin marketing. In Japan, the duty on avocados was reduced from 10% to 6% over a period of 8 years.

Extensive promotion and marketing were essential to our penetration of the Japanese market. Since our first full container-load shipment to Japan in 1977, we have increased avocado exports to Japan by more than 600%. However, the remaining 6% duty on avocados intensifies competition for U.S. avocados with Mexico because Mexican avocados enjoy GSP status in Japan. We urge you to press our negotiators to achieve removal of the remaining Japanese duty.

In Europe, particularly in France, the market increased dramatically this year for U.S. avocados largely due to the failure of the Israeli crop. We would like to continue to expand the European market for U.S. avocados. However, Israel, our main competition, enjoys a preferential tariff advantage in that is pays only a 1.6% duty while the U.S. must pay an 8% duty on avocados exported to the EEC. Such preferential tariffs are blatantly illegal under the Most Favored Nation (MFN) provision of the GATT and the United States should insist that this preference be eliminated.

STRICT STANDARDS FOR FOREIGN PEST CONTROL

The California avocado industry is vitally concerned that USDA's Animal and Plant Health Inspection Service (APHIS) continue to provide protection to our industry by maintaining high standards for agricultural products coming into the United States from countries or areas infested with exotic pests and diseases. Our industry has virtually eliminated all pest problems and thus does not require the use of pesticides. This is in the best interest of the environment and economy of production. However, avocados are very vulnerable to certain exotic pests which, if allowed to enter the United States, could have a devastating impact on our industry, as well as on many other specialty crop industries in California.

An ongoing concern is the potential of avocado seed weevil infestation from Mexico. The presence of seed weevil in Mexico is unquestioned. The United States is free of seed weevil. APHIS Quarantine regulations currently prohibit Mexico from shipping uncut avocados into the United States. Two years ago, a relaxation of current restrictions on the importation of avocados from Mexico was considered by APHIS and ultimately rejected.

If seed weevil were introduced into the United States, the consequences for our industry would be severe. Our concern is compounded by the fact that Mexican fruit fly is also present in Mexico. Introduction of the Mexican fruit fly into the United States would be adverse not only to the avocado industry but also to others, such as the citrus industry.

A most recent example of the need for constant vigilance with regard to foreign pests is the recent outbreak of the Mediterranean fruit fly (Medfly) in California. We are very concerned that the Medfly infestations in Santa Clara and Alameda counties of California be erradicated. Although there is no commercial production of avocados in these quarantined areas, avocados are a primary host of the Medfly. We are heartened by indications that the control program has been successful. However, efforts to ensure erradication must continue. A general outbreak of the Medfly would cost California agriculture hundreds of millions of dollars in production and result in the quarantining of United States agricultural exports by such foreign countries as Japan, a major importer of avocados.

A related area of concern for our industry is the recent decision of the United States Department of Agriculture, the Customs Service and the Immigration and Naturalization Service to liberalize passenger and baggage inspection at Los Angeles and Miami International Airports for a six month trial period. The modified procedure is being proposed as an aid to Customs officials and as a convenience to passengers.

Passengers returning to the United States often carry animal and plant products in their personal baggage. Fresh fruit is the most frequently intercepted contraband. We are very concerned that the selection of Los Angeles International Airport as a test site for this new inspection procedure poses a real danger to our industry by substantially increasing the risk of introducing plant pests or animal organisms into the United States. Indeed, it is widely assumed that the Medfly infestations in the Los Angeles region in 1975 and 1980 originated through Los Angeles International Airport. According to studies by the State of California, the establishment of the Medfly might well result in losses to California's agricultural yields in excess of $100 million annually. To date, the State of California and the USDA have spent in excess of $17 million and $2 million respectively, in eradicating the existing California Medfly infestation. While we question the wisdom of modifying vigilence at ports of entry anywhere in the United States to benefit passenger conveniences and to reduce the work activity of the Customs Service personnel, experimenting at Los Angeles International Airport appears particularly inappropriate.

Of particular concern is the fact that the basis for the selection of Los Angeles International Airport over other sites and the conditions of the experiment have never been presented for any prior review or comment by Members of the Congerss, representatives of the California State government, or interested members of the general public, including representatives of California agriculture who may be substantially affected by the proposed experiment. This appears to be a violation of the spirit of the Administrative Procedure Act and Executive Order 12291 recently issued by the President in an attempt to have federal agencies base their decision on adequate information concerning the need for, and consequences of, proposed government action.

In view of the potential disasterous impact that this experiment may have on agricultural commodities such as avocados, it is urged that efforts continue to have the involved agencies delete Los Angeles International Airport as a test site.

GENERALIZED SYSTEM OF PREFERENCES

The California Avocado Commission is opposed to the inclusion of agricultural products on the list of items eligible for the Generalized System of Preferences (GSP). Congress enacted the GSP in 1974 as a ten-year experiment to unilaterally give a trade advantage to the lesser developed countries (LDCs). The program has not been a success and should be eliminated. At the very least, those five nations (Mexico, Taiwan, Hong Kong, South Korea and Brazil) who receive 70% of the GSP benefits, while the other 135 LDCs share the remainder should be "graduated" from the GSP list, as they are among the world's most successful exporters and do not need the advantage of GSP status. For avocados, this is particularly true with regard to Mexico.

CONCLUSION

The California avocado industry appreciates the opportunity to express our concerns with regard to international trade. We are pleased to see these Committees and the Congress as a whole concentrating on the need to improve our trade status.

Our industry is making a significant contribution to U.S. agricultural export activity. With your continuing assistance, the export future of the avocado industry is highly promising. We seek your help in seeing that the Executive branch continues its aggressive export market development program for agricultural exports and that it presses for elimination of the Japanese duty on avocados. We also urge you to keep a watchful eye so that the current high standards for pest control are maintained by APHIS. The potential damage which would be caused by a seed weevil or Mexican fruit fly infestation is enormous. The recent Medfly outbreak in certain areas of California is also potentially devastating to our industry and only serves to heighten our concern over the proposed use of Los Angeles International Airport as a test site for liberalized customs inspection procedures.

Respectfully submitted,

Ralph M. Pinkerton

Ralph M. Pinkerton
President

Submitted: July 22, 1981

N·H·A National Handbag Association
350 FIFTH AVENUE • NEW YORK, N.Y. 10118 • (212) 947-3424

EXECUTIVE DIRECTOR: EDWARD S. LEVY

STATEMENT FOR THE RECORD OF
UNITED STATES TRADE POLICY

FOR THE

FINANCE SUB COMMITTEE ON INTERNATIONAL TRADE
BANKING SUB COMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
UNITED STATES SENATE

JULY 23, 1981

Mr. Chairmen and members of the Sub Committees:

The National Handbag Association respectfully submits this statement concerning United States Trade Policy on behalf of the nation's handbag industry.

The National Handbag Association is a trade association representing over 150 domestic manufacturers of women's handbags in the United States. Virtually all of our production workers are members of the International Leather Goods, Plastic and Novelty Workers' Union, AFL-CIO.

By comparison with many other industries, the handbag industry is relatively small, employing approximately 20,200 people in about 400 manufacturing establishments. The contribution to the economy which this industry makes, is shrinking under the weight of imports. However, the industry continues to provide jobs in and supply payroll for many communities across this country. As small as this industry may be, it is not an unimportant customer for other industries. In 1977 alone, the handbag industry purchased almost $180 million worth of materials and supplies, including $63.1 million in plastics and $34.3 million in finished leather. Our industry is proud of its achievements in style, creativity and genuine American know how.

Import Impact Has Been Severe in Handbag Industry:

No industry can withstand such persistent import competition, and, the handbag industry is no exception. During recent years, when the United States economy experienced market growth, the situation in the handbag industry could be described as stagnant. Annual industry indicators (production, employment, profits, and new plant investment) have been generally discouraging. The fact is that domestic output in most years declined proportionately to domestic consumption, resulting in the expanding share of the total market going to imports. Statistically, between 1970 and 1980, imports had a much more consistent and pronounced upward trend than did domestic shipments. In 1970, domestic output was at 83.9 million units falling dramatically to 53.5 million in 1980. During that same period of time, imports increased from 56.6 million units to a staggering 143.7 million. Imports of handbags in 1970 accounting for well over 55 percent of the domestic market, skyrocketed to over 74.5 percent in 1980.

It needs to be stressed that the gains made by imports at the expense of domestic production and employment are not due to style or quality, but, primarily due to price advantages. These can be attributed to three factors:

(1) lower foreign labor costs
(2) the Kennedy Round U.S. Tariff cuts, which sliced the U.S. import duty on leather and reptile handbags by 50 percent, and;
(3) the maintenance by foreign supplying governments of export incentive programs, which convey competitive advantages to foreign exporters to the U.S. market.

Rising levels of imports of handbags, particularly since the conclusion of the Kennedy Round, have created major disruptions in the domestic industry. The result has been declining production, declining jobs and declining capacity in this industry.

One of the major points to be considered by this Committee is that handbag imports from other countries can make inroads on American-made goods only on the basis of price. United States goods compare favorably with foreign made merchandise in all other categories. Foreign markets have been able to penetrate successfully only because of their definite advantages in terms of lower wages and direct subsidies and incentive programs provided for by their own governments.

National Handbag Association Suggested Proposal:

This industry is bent on survival. We have always fought for what we believe in. In 1974, when the Department of Commerce established the Trade

Act, it was this industry that rallied for technical assistance for import impacted firms. It was this industry that became the first recipient of an Industry-Wide Technical Assistance Grant from that same area of government.

In 1977, when our government began investigating countervailing tariff situations, it was this industry that actively testified. During that same year, when it became apparent that import competition would remain a threat to domestic manufacturing, this industry pioneered an export strategy program in several foreign market areas. Since that time, the handbag industry has continued on a positive trend towards export. In 1979, we exported 3.2 million units valued at $11.0 million and in 1980 that figure rose to 4.2 million units valued at $15.5 million, an increase of 33 percent in quantity and 41 percent in value. Within the first six months of 1981, we exported 2.9 million units valued at $8.0 million.

In order for our industry, and others like us, to gain an even footing with our foreign competitors, we would require assistance from our government in the form of incentive programs. These programs could only aid our manufacturers in becoming more trade competitive. It would also encourage healthy businesses to seek alternative channels for expansion and growth. And, most importantly, it would give the much sought after "shot" of adrenaline to those industries severely hurt by imports.

As a manufacturing organization, we thank you for the opportunity to express our views on the important area of United States Trade Policies. We avail ourselves to the committees for any further consultation.

Sincerely,

Edward S. Levy

Edward S. Levy
Executive Director
National Handbag Association

STATEMENT

of

AMERICAN IMPORTERS ASSOCIATION

Mr. Chairman and Members of the Committee:

The American Importers Association (AIA) is a nonprofit organization formed in 1921 to represent American companies engaged in the import trade. As the only association of national scope representing American firms directly and indirectly involved in the importation and distribution of imported goods, AIA has long been the recognized spokesman for importers throughout the nation.

We welcome this opportunity to present our views on the need for a comprehensive trade policy. Simply stated, such a policy might be defined as one that recognizes the close interrelationships between imports, exports and domestic economic activity whenever economic policy is made.

Our association's growth reflects this same interdependence. While we are an association of importers, many of our members are now actively engaged in exporting. (Many are also domestic manufacturers, several of considerable size.) They have urged that we incorporate export activities into our basic organizational framework--a process that we have already begun. AIA's export activities will reflect the fact that many of our members are engaged not just in "importing" or in "exporting" per se, but in the buying and selling of goods wherever a market presents itself--they are engaged in world trade.

That importing is itself a big business in the United States should not be ignored. Most major multinational companies and many small businesses are directly involved in importing. Altogether American companies handled $240 billion in import trade in 1980. There are approximately 35,000 independent importers and 1.8 million retail establishments in the United States that are dependent to a substantial degree on imports. The retail establishments alone employ 15 million workers, almost 17 percent of the total labor force. Imports, therefore, play a major role in the U. S. economy.

I. A COMPREHENSIVE TRADE POLICY IS VITAL TO ECONOMIC RECOVERY

AIA strongly supports the adoption of a comprehensive trade policy. None exists today. The United States presently pursues separate policies toward imports and exports, trade with developing countries, Japan, Europe, steel, automobiles, textiles and apparel, and footwear, to name but a few. All too often, we see these issues dealt with on a short term, ad hoc, political basis. Invariably, fundamental domestic economic needs and long term national interests are given little attention or ignored altogether.

We are now in the midst of a historic debate over how to put the American economy back on track. Presented in its starkest terms, it is between those who favor open and competitive business as an element in fostering a strong and dynamic economy, and those who favor strong government intervention to protect various segments of the U. S. economy from free competitive forces. AIA believes we must have a strong, internationally competitive economy producing a better standard of living for all Americans. The steps necessary to the attainment of that goal are clear. We must reduce inflation. We must increase our commitment to R&D. Business investment and worker productivity must be increased. The crushing burden of overregulation must be reduced. Market forces must be given a chance to work.

As Administration witnesses have already testified at these hearings, trade can and should play a vital role in any program for economic recovery. Before this can happen, however, we must do a better job of coordinating trade policy and integrating it fully into the framework of broader economic policy. Policies which insulate important sectors of the economy from foreign competition undermine the nation's broader economic goals. Import protection is merely another means by which the government contributes to the misallocation of scarce capital and labor resources to increasingly non-competitive industries. This has the effect of withholding these same resources from higher wage, high technology "growth industries," where the United States is a world leader or may become one. Not coincidentally, most of our growth industries are significant exporters. In short, we cannot put the American economy back on track by robbing Peter to pay Paul; we cannot expand American exports while curbing imports.

II.EXPANDED TRADE SUPPORTS THE REAGAN ECONOMIC RECOVERY PROGRAM

As importers, we speak from the perspective of companies all too familiar with the impact of government regulation on business. We are subjected daily to a myriad of policies and regulations which fall loosely under the general rubric of "trade policy". It is largely a trade policy based on narrow sectoral interests and disassociated from either export policy or long term domestic economic interests.

It is time to take a more enlightened approach, one that considers trade as a positive factor in our economic well-being, a stimulus to competition and the efficient allocation of resources, and a primary impetus to industrial restructuring. This approach must recognize the reciprocal nature of trade -- imports as well as exports are vital to our economy. Finally, it must recognize that economic policy cannot be pursued seriously without a trade policy which complements, rather than contradicts, our overall economic objectives.

As Mr. Weidenbaum pointed out, trade plays an important role in the U. S. economy. Imports, for instance, provide undeniable benefits in the fight against inflation. Imports of lower cost raw materials and semi-manufactured products help keep down the final cost of finished manufactured products in the United States and, in the process, help our exports remain competitive in international markets.

Consumers also benefit directly from imports. A Brookings Institution study found that imported goods on average cost 10.8 percent less than comparable domestic goods. Low income consumers fare even better -- the study indicates that imported products likely to be purchased by this group cost 13.1 percent less than comparable domestic products.

Imports provide needed competition in the domestic marketplace. Who can doubt that the United States automobile industry's belated shift to the production of small, fuel-efficient cars arrived far sooner in the face of strong import competition than would otherwise have been the case?

Import restraints, on the other hand, raise prices, restrict competition and contribute to our inflationary ills. We must avoid the temptation to view each isolated trade restriction as relatively noninflationary, given the magnitude of our overall economy. The cumulative impact of many separate actions have a significant impact on domestic inflation rates.

A recent study by Chase Econometric Associates has found that the average price of new cars sold in the United States can be expected to rise by three percent as a result of the "voluntary limit" negotiated on Japanese automobile exports. A Consumer Reports study of this same restraint agreement came to the following conclusion:

> "The net effect: Many auto-industry analysts are projecting that both Japanese and American small cars will cost $200 to $400 more than they would have without the quota agreement. At the same time, consumers will have little choice but to buy a loaded or top-of-the-line model.
>
> While the quotas will lead to higher prices, they'll do little to encourage Detroit to build

automobiles whose quality matches that of the Japanese imports."

Our minimum price system for imported steel has the effect of increasing the cost of steel in this country. This type of direct subsidy to domestic steel producers badly undercuts the U. S. automobile industry, which desperately needs to reduce costs to compete with foreign car manufacturers. U. S. exporters of industrial machinery and equipment, also major users of steel products, are equally disadvantaged.

A 1978 study by the Council on Wage and Price Stability on the costs of textile and apparel protection found that quotas and tariffs on textiles and apparel cost consumers almost $3 billion a year. A 1979 FTC staff study estimated that the consumer costs of import restrictions on non-rubber footwear since 1977 totalled over $1 billion and the cost to consumers of import protection for sugar totalled over $1.5 billion over a three-year period. Presently, 25 percent of all dutiable imports, apart from petroleum, are under one form of protection or another. We cannot continue in this direction and speak seriously, at the same time, of the need to curb inflation.

If we are serious about revitalizing our economy and improving our position internationally, one of the primary goals of our overall trade policy must be to develop trade programs which encourage the shift from low wage, semi-skilled industries where the United States is increasingly noncompetitive, to growth industries where the United States is internationally competitive. Production in areas such as chemicals, fabricated metal products, and electric and non-electric machinery has increased far more than iron and steel or apparel. These same growth industries are our major exporters as well as our future.

AIA does not wish to suggest that certain industries should be abandoned. The alternative to protecting the inefficient, incompetent parts of our existing industry is not total abandonment of the entire industry. Even in labor intensive industries such as footwear and apparel, and certainly in our steel industry, restructuring is already taking place which will result in productive, viable industries. In every troubled domestic industry, there already are important segments that compete very successfully against foreign competition both here and abroad. But we must ask ourselves: What is our vision of the country's future? Where do we want to be in the year 2000? In answering these questions, we must recognize that America has changed over the years, as has the rest of the world. One key to our success as a nation is that we have been in the forefront of change. Our economy is particularly suited to adapt to changing economic conditions, if it is allowed to. Our competitive position in labor intensive sectors of certain industries such as apparel, footwear, steel, and automobiles, has deteriorated over the last twenty years. On the other hand, the United States has maintained or improved its competitive status in many areas, including research intensive industries, agriculture (which is highly capital intensive), and services. This ability to compete is reflected in the ability to export.

The value of U. S. exports of agricultural products grew by over 475 percent between 1970 and 1980, and the U. S. balance of trade in these products went from a surplus of roughly $7 billion to almost $24 billion during the same period. Between 1970 and 1979, U. S. exports of R&D intensive manufactured products, as defined by the National Science Foundation, increased by over 310 percent, from $19.3 billion to $79.1 billion. In 1979, alone, the U. S. trade surplus in R&D intensive products exceeded $39 billion. U. S. trade in services also grew rapidly over the decade: from rough equivalence in 1970 to surplus exceeding $34 billion in 1980.

Despite these favorable trends in our economy's structure, we as a nation continue our obsession with protecting non-competitive industries to the detriment of our exports.

Exports now comprise an increasingly important segment of our economy. In 1980, exports represented 19.2 percent of all final sales and changes in inventory compared to only 9.3 percent in 1970. Expanded exports are necessary if we are to pay for those critical imports, such as imported oil, chromium, tin, iron ore, etc., on which our economy is dependent. Expanded exports will also benefit the economy by providing more higher-skilled, higher-paying jobs.

A comprehensive economic policy must recognize the importance of trade policy in any conscious program for economic recovery. Integral to this policy is a recognition of the reciprocal nature of trade -- i.e., it is not possible to pursue, successfully, export expansion and import restriction simultaneously. Rather, as Mr. Weidenbaum points out, "The only way in the long run to increase our exports is to increase our imports." To pursue a policy of increased trade is to recognize that this will contribute to our broader goals of lowering inflation, increasing productivity and ultimately increasing our GNP.

In contrast, restrictive trade policies only reinforce present inflationary tendencies in our economy by eliminating competitive factors that might otherwise moderate future cost increases, while encouraging continued inefficiencies and higher prices. They also divert limited investment resources from the segments of our economy most productive to those least productive. They shift our orientation from future possibilities to past problems. The long-term implication of such policies is the erosion of the United States' competitive position in those segments of our economy most likely to provide growth and better job opportunities in the future.

III. INCREASED EXPORTS DEPEND ON CONTINUING ACCESS TO THE U. S. MARKET

AIA strongly supports efforts to expand U. S. exports of goods and services, through removal of artificial barriers to trade. But the United States cannot expect to maintain or improve access to foreign markets if, at the same time, we restrict access to our own market. In basic economic terms, growth of U. S. exports is founded on increasing foreign purchasing power. Politically, it is unrealistic to ask others to open their markets to our goods at the same time that we restrict their access to our market. Unless we construct a trade policy that relates import policy to export needs, we will make little headway in the area of export expansion.

As an important step toward framing a comprehensive trade policy, the United States must acknowledge its favorable export position. U. S. trade performance in 1980 was relatively good, particularly in light of current global economic difficulties:

-- While the United States had an overall merchandise trade deficit of $27.4 billion, it achieved a $51 billion surplus in its non-oil merchandise trade.

-- The merchandise trade deficit was more than offset by a $34 billion surplus in the services sector.

-- The U. S. current account balance, after official transfers, was in overall balance.

-- In contrast to the experience of the United States, Germany and Japan ran current account deficits of $16.0 billion and $10.8 billion, respectively.

-- While the United States showed a $10 billion trade deficit with Japan in 1980, we had an $18 billion trade surplus with Europe the same year.

This last set of figures underscores an important point. It is counterproductive to seize upon simplistic statistics such as bilateral trade deficits to justify restrictive actions against Japan when these very same arguments leave us vulnerable to similar actions by Europe. Similarly, by segmenting our balance of trade figures, we weaken our argument for improved access in services, an area in which we are clearly the world's leader.

Improving access to world markets depends, in large part, upon reliable multilateral trade rules. Without such rules, the world trading order threatens to break down into a series of bilateral trade disputes which have a tendency to multiply. We see this happening right now as U. S./Japan, U. S./EC and EC/Japan trade disputes, framed superficially in terms of bilateral trade deficits, illustrate. The world trading order now faces a real danger of collapse under the strain of present economic conditions as nations come under increasing political pressure to restrict access to their markets in order to protect noncompetitive segments of their economies. In response to this process, the GATT recently called for a meeting on protectionism at the Ministerial level in 1982, the first such meeting since the Tokyo Declaration in 1973.

This threat to the multilateral trading system is not imagined. It is real. Examples abound from European and American restrictions on imports of steel, automobiles and textiles to the recent call by Prime Minister Thatcher for selectivity in Article XIX proceedings. Of all these actions, the call for selectivity may, in the long run, pose the greatest threat because of its seductive appeal and the implications for an accelerating shift to bilateralism.

Most-Favored-Nation (MFN) treatment has long been the bedrock of United States and world trade policy. It prohibits discrimination among nations by requiring that trade benefits and restrictions be applied equally to all nations. Prime Minister Thatcher is proposing an exception to the MFN principle based upon the desire to discriminate, through selective trade restrictions, against individual countries found to be the source of injurious imports. While the United States continues to oppose selectivity in principle, it has de facto applied selectivity in the case of Japanese automobile exports to the United States and in Orderly Marketing Arrangements negotiated under the Trade Act.

The question facing the United States is whether we should abandon the policy of MFN, and thereby encourage a trade policy that responds to short-term pressures for import protection, or maintain the basic rule of multilateral trade, based on our present and long-term stake in open world trade.

The United States should continue to adhere to the MFN principle today, not out of generosity, but with the clear understanding that we are increasingly vulnerable, as the world's largest exporter, to restrictive actions abroad. While the abandonment of MFN would make it easier to impose restrictions on imports which threaten less competitive segments of our economy, we could pay a greater price in terms of reduced access to world markets for U. S. exports. Discriminatory restrictions already have been applied against U. S. man-made fiber yarn exports to the United Kingdom in 1980. We must consider carefully the danger of selective actions in the future against U. S. exports of computers, or possibly the new generation of medium-range aircraft.

If we hope to expand our exports, we must also understand that our trading partners must have the foreign exchange to obtain those goods. This is particularly true of developing and Eastern bloc countries.

U. S. foreign trade with developing countries has grown enormously over the past decade. The value of U. S. trade with developing countries -- exports and imports -- reached nearly $200 billion in 1980, roughly eight times greater than in 1970. Further gains in the coming decade will continue to rest, in large part, on the ability of the developing countries to expand their exports of manufactured goods to the United States and other industrialized nations.

Both sides benefit in this exchange of goods and services. For developing countries, increased exports support desperately needed economic growth and raise living standards. For the United States, additional imports from the developing countries provide the basis for expanded exports of products produced by farmers and manufacturers in this country, increase competition within the domestic marketplace, fight inflation and expand the range of goods available to the American consumer.

The reciprocal nature of this trade is reflected by trade patterns. United States merchandise imports from the developing countries (excluding OPEC), for example, increased by $53.4 billion over the past decade. U. S. exports rose over the same period by $54.2 billion. The share of total U. S. merchandise exports to the developing countries (excluding OPEC) has risen steadily during this time-- from 21 percent of our exports in 1970 to 29 percent in 1980.

Exports of agricultural products to developing countries have increased to the point where they now account for 35 percent of total U. S. agricultural exports. The importance of developing countries as markets for America's farmers is even more pronounced in individual product sectors. The large and growing U. S. export trade in cotton, for example, is based increasingly on trade with developing country markets. Nearly 63 percent of U. S. cotton exports in 1980, valued at over $1.8 billion, was shipped to developing countries and China.

The developing countries are an equally important outlet for U. S. manufacturers. They purchased roughly 39 percent of

U. S. manufactured exports in 1980, valued at $64.8 billion. A majority of these exports are composed of machinery, transportation equipment and chemicals. In virtually every major manufacturing sector, exports to the developing countries over the past decade increased both in real dollar terms and in relation to total U. S. exports. Obviously, as these economies develop further, their need for high technology products such as computers will increase as well.

Clearly, developing countries represent a major opportunity for expanded U. S. exports. Increased exports over the past decade have created hundreds of thousands of new jobs within the U. S. agricultural and manufacturing sectors. Today it is estimated that over 750,000 American manufacturing jobs can be attributed directly to exports to non-OPEC developing countries, with as many as 475,000 jobs created in non-manufacturing sectors of the economy.

Past trends notwithstanding, future export expansion with the developing countries is in jeopardy. The non-oil developing countries are faced with an increasingly difficult situation because of rising payments deficits. These deficits are the result of a number of factors including weakening demand in the industrialized countries which are the export markets for developing countries, the high cost of oil, and the high cost of borrowing to finance existing deficits. One likely result will be a reduction in import demand in these countries -- or stated another way, a reduction of U. S. export opportunities.

As Ambassador Brock pointed out in his statement, in order for these countries to continue to import from the U. S. and other industrialized countries, they must increase export earnings. This will be difficult enough as a result of deflationary policies presently being pursued in many countries, including the United States. If this is made more difficult by United States restrictions on imports of products of primary importance to the developing countries, including labor intensive products such as apparel and footwear where they are internationally competitive, the prospects for meaningful U. S. export expansion to these markets will be minimal. The adverse impact will multiply if our major industrialized trading partners use our actions to legitimize their own restrictions against developing countries as has happened in the case of textiles and apparel and footwear.

Access to the U. S. market must be maintained if we hope to reverse the worldwide trend toward restricting markets, which now threatens to engulf the multilateral trading system. In practical terms, this means resisting the temptation to formulate short-term trade policies based on the demands for subsidies, in the form of import restrictions, by the least competitive sectors of our economy. All too often, imports have proven to be a convenient scapegoat for fundamental problems facing U.S. industries. For instance, imports are not the cause of adverse trends in productivity, capital investment, and research and development expenditures cited by Ambassador Brock in his statement. If we are to address these fundamental issues, we must limit import restraints to those cases in which there is proven injury caused by imports and a determination that temporary relief is a necessary and effective means of adjustment. Adjustment policy should focus on the long-term goal of assisting workers and industries to shift to more highly productive and competitive economic activity.

A decision to impose import relief has wide-ranging implications for the U. S. economy and export performance. It interferes with free market decisions necessary for the most efficient allocation of capital and human resources. It forces consumers to pay subsidies for domestic industries that have not remained competitive. It is inflationary. Import relief can also lead to a situation where the U. S. either is obligated to compensate its trading partners in the form of trade concessions or becomes vulnerable to retaliation. In either case, import relief has the effect of creating disincentives to export and limiting U. S. access to foreign markets in the very export competitive goods where we should be encouraging production.

For these reasons, a comprehensive policy which provides for import relief should focus on minimizing its application to instances where it is absolutely needed in order to provide domestic industries a breathing space to adjust to competition. Import relief also should be tailored with other measures to realize these goals with mimimum interference to free market forces and be limited in duration so that a truly free market can return to full operation as swiftly as possible. As Ambassador Brock stated:

> Adjustment assistance and safeguard measures can ease problems of dislocation for firms and workers, but they do not of themselves effectuate adjustment. It is U. S. policy to place primary reliance on market forces to facilitate adjustment in affected industries.
>
> Import restrictions, subsidies to domestic industries, and other market distorting measures should be avoided. A better solution to the problems associated with shifts in competitiveness is to promote positive adjustment of economies by permitting market forces to operate.

The current statutory scheme for import relief under Section 201 of the Trade Act of 1974 provides the most effective mechanism for determining import relief needs in the context of our national economic self interest. As an organization of businessmen experienced with the results of pressures for import relief unrelated to legitimate economic need or the national interest, AIA strongly opposes any legislative effort to tamper with the present law which would allow industries to qualify for import relief without proving serious injury.

Trade restrictions without economic justification and adequate procedural safeguards serve no valid national purpose and unfairly penalize the operations of importers, retailers, and domestic manufacturers who depend on imports. Import relief provided under Section 201 differs from pure subsidies directed to special interests only insofar as present legal standards are met and the actions taken are of a temporary nature to allow domestic industries unable to compete in a free market to adjust. Imports frequently are blamed for injury caused by other factors. Yet, if imports are not the "substantial cause" of serious injury, trade restriction fails to address the real problems facing the industry concerned, while imposing substantial costs on the economy as a whole.

The United States experience with import restraints established outside the statutory provisions of Section 201 has shown them to be costly and contrary to our national economic interests. "Voluntary" restraints on automobile imports, the Trigger Price Mechanism (TPM) on steel and textile quotas all amount to special interest subsidies.

The "voluntary" restraint on Japanese automobile exports is a perfect example of the present dilemma of the world trading system. In terms of the automobile industry itself, there simply was no economic justification for these restrictions, as the International Trade Commission recognized. Yet trade disputes with Japan in recent years, including the emphasis on bilateral trade deficits with Japan, combined with the self-inflicted wounds of the domestic automobile industry, produced strong political pressure for trade restraints. While these restraints will do little to help U. S. automobile producers or workers, as the producers now acknowledge, they will increase the cost of automobiles and hurt efforts to conserve energy. These restraints also have legitimized European efforts to restrain Japanese automobile imports.

In steel, the TPM was established with the rationale that foreign producers could not export to the United States at prices below trigger prices without selling below fair value. Despite this rationale, the TPM is nothing more than a minimum price scheme created because the antidumping law provided the domestic industry with a virtual veto power over policy decisions by the Administration in the steel sector. The problems of the steel industry -- more specifically those of the integrated steel producers -- have been caused primarily by wages two-thirds higher than those of the average U. S. manufacturing worker, low growth in productivity, inadequate depreciation schedules, obsolete facilities, investment by the steel companies in other industries, and excessive environmental regulations. On the other hand, many segments of the steel industry are not experiencing the difficulties generally associated with the industry as a whole. Newer, more efficient and productive non-integrated producers are able to compete with imports.

In spite of the fact that severe import competition is concentrated within only a few product areas, the Commerce

Department has refused to reduce the product coverage of the TPM. Rather, it has maintained these unnecessary restrictions on imports which have no adverse impact on the domestic industry -- some of these products are even imported by these same "injured" domestic producers.

Foreign and domestic steel producers alike favor the continuation of the TPM because it is an officially managed minimum price scheme. At the same time, the TPM reduces the competitiveness of our finished manufactured products, such as automobiles, in world markets by artificially increasing the costs of these products.

The textile and apparel industries have had 25 years of protection which now covers all textile products on a comprehensive quota basis from all major supplier countries (except Europe), together with the highest level of tariff protection of any U. S. industry. Despite this history of restraints, the domestic industry continues to fight at the highest political level for additional restraints. Even as the President was proclaiming in Ottawa that the industrialized nations have "resolved that we shall resist protectionism and support an open, expanding system for multilateral trade," U.S. negotiators in Geneva were pressing for a tighter multilateral regime to control textile and apparel imports.

While the textile industry battles for additional protection against imports, domestic producers have become the leading exporter of textile products to the European Community. Total exports from the United States to the EC grew by 65 percent from 1978 to 1979 and at an average annual rate of 13.6 percent between 1976 and 1979. (At the same time, total imports from countries having bilateral textile agreements with Europe grew by only 2.4 percent from 1976 through 1979.) The primary component of the impressive U. S. export performance was in the textile mill sector where the value of U. S. exports reached $3.6 billion in 1980. In response to calls for restraints on U. S. textile exports to the EC, U. S. manufacturers have responded that they should not be restricted by their less efficient European counterparts.

As a result of the impressive export performance of the U. S. textile mill sector, we now have the spectacle of the United States demanding increased import restraints on textile mill imports at the same time that it is running a $1 billion trade surplus in that sector. Nothing could better demonstrate how import restrictions, if not strictly limited to a temporary period for adjustment to competition, evolve easily into a permanent special interest subsidy. While we support the growth of these U. S. exports, we cannot help but feel that the efficiency of the U. S. industry likewise justifies the elimination of restraints on U. S. imports of textile mill products.

Access to foreign markets also is essential if the United States is to meet the changing needs of the U. S. labor force.

As we are all aware, our labor force is maturing. The Bureau of Labor Statistics has determined that in the 1980's the largest increases in the labor force will be in the 35-44 year age group, while workers in the 16-24 year age group will actually decline. This work force already has received more education and has higher expectations than its parents, with over 85 percent of younger workers currently high school graduates compared to 61 percent in 1960 and 38 percent in 1940. Increased exports will provide the types of high paid, high skilled jobs needed for this work force.

There is no question that an export-oriented open market trade policy will result in some dislocation in the less competitive sectors of our economy. Political pressure and economic realities being what they are, it will not be possible, in the long run, to pursue this trade policy without a viable program for worker and company adjustment. The shortcomings of the present program have increased the clamor for additional import restrictions. It is essential that a program be designed to insure that workers most affected by these policies not bear a disproportionate share of the costs and that they be provided with the opportunity and means to benefit from these policies along with the other members of the labor force. This requires radically improved job training, assistance in finding new jobs, and possible relocation to areas where these new jobs exist. In the past, too much emphasis was placed on "paying off" these workers by extended unemployment relief. We are encouraged by the recent changes in the trade adjustment assistance program put forward by the Administration which emphasize the positive aspects of adjustment and which focus on those substantially affected by import competition. We also should not underestimate the ability of the market to adjust to changes without government intervention or assistance. This process occurs daily in areas having nothing to do with imports or import competition and is the essence of a dynamic economy.

Improving U. S. access to foreign markets, then, is more than simply encouraging U. S. exports or reacting against foreign restrictions on our trade. It requires a recognition of the importance of a long-term commitment to the maintenance of an open world trading system. It requires that we resist short-term pressures from our least competitive manufacturing sectors while investing in our productive sectors. We are not advocating the abandonment of import relief. We are advocating adherence to a system limited strictly to those cases of serious injury where temporary relief is absolutely necessary to assist the process of adjustment. Further, we urge the development of an adjustment program that truly aids the process of assisting workers affected by import competition in the development of new skills in the more productive sectors of the economy. Such a program also will help us build a strong economic base for the future.

IV. DISINCENTIVES TO EXPORTING

If the Reagan economic plan has one message, it is that the marketplace, not the government, should allocate resources. One impediment to the rational and efficient allocation of resources up to now have been the artificial disincentives to export which have been created unilaterally by the United States. The deficiencies in the Foreign Corrupt Practices Act are an important example of such disincentives.

AIA supports the amendments proposed by Senator Chafee to the Foreign Corrupt Practices Act. The present standards of the Act are vague and burdensome to U. S. exporters. We concur with U. S. Trade Representative Brock when he identifies the Act as perhaps the most important trade issue before us because it represents a "self-imposed constraint to export" which has been imposed "in a self-defeating manner."

While the law is well intentioned, its standards remain vague thereby posing a serious threat to honest American businessmen. Present law also does not take account of foreign customs and standards. If the United States is to be a competitive exporter, cultural differences which do not violate fundamental standards of behavior must be recognized.

While proposed amendments to the Act would continue the prohibition against bribery of foreign officials, they would refine and clarify its provisions so that companies would no longer be in a legal quandary over their obligations under U. S.

law. We believe such amendments are far more likely to promote the original objectives of the Act, without unnecessarily creating counterproductive barriers to U. S. exports, than were the old standards. As businessmen, AIA supports these corrections to the original Bill which will allow Americans to compete more freely in international markets.

Another potentially serious limitation on our ability to export is the U. S. educational system. A number of studies have shown that U.S. primary and secondary school education in science and mathematics is not competitive with those of Japan, the Soviet Union and many European countries. While all Soviet high school students are required to complete five years of physics, for instance, fewer than one-tenth of American high school students take even one year. Similar deficiencies exist in the area of foreign languages, which obviously has had a very real impact on the ability of Americans to market their goods overseas.

If this "education gap" between the United States and our primary competitors continues, we can expect further problems in productivity and in maintaining our technological supremacy.

There are no easy answers to this problem. We do, however, suggest that problems in education are related to the better known problems of decline in productivity and research and development expenditures cited by Ambassador Brock in his testimony. In the short run, our current economic ills are less related to the education problems than to those cited by Ambassador Brock, but we believe that Administration budget cuts in the area of education have the potential of further limiting our ability to compete in world markets in the long term. For these reasons and for reasons of national security, AIA believes improved education should be a high priority for this Administration.

V. EXPORT/IMPORT BANK AND EXPORT CREDIT SUBSIDIES.

If the United States is to remain competitive in world markets, it must remain competitive in export financing. It would be preferable if international competition in the credit market were free of government financing, but this is not now the case. Other nations finance their exports and this has led to a serious dispute over the use of government financed export credits. This dispute has not been resolved and is unlikely to be resolved favorably if the United States unilaterally refuses to compete with other nations in financing exports. In the absence of a workable international agreement on export credit subsidies, United States companies must be able to look to the Export/Import Bank as a source of competitive funds to prevent the loss of sales to foreign competition.

For these reasons, AIA opposes efforts to reduce funds available to the Bank for direct lending and supports Senator Heinz' Bill (S. 868) to amend the Export/Import Bank Act of 1945 to provide additional funds to the Bank as a "war chest" if the

United States is unable to reach a workable international agreement within one year.

While we support increased direct lending by the Bank, we also believe that the Bank must make greater efforts to target direct loans to those instances where exports would not be possible but for the intervention of the Bank. We agree with the concept advanced by the Administration that exports which would be made in any event, with or without Bank intervention, should not be beneficiaries of low interest loans from the Bank. On the other hand, it is easy to envision examples, such as the case of U. S.-produced medium range aircraft which are now in strong competition with similar aircraft produced in Europe, where U. S. exports would be seriously reduced in the absence of Bank assistance. The United States cannot afford to engage in "unilateral credit disarmament" absent an agreement with our trading partners on the issue.

VI. USE OF TRADE FOR FOREIGN POLICY PURPOSES

AIA is not a political organization and does not address political questions regarding particular countries or groups of countries. At the same time, we recognize that trade is linked to broader foreign policy considerations. Deteriorating trade and economic relations are destabilizing and historically have threatened peace. As such, in the broader sense, we believe it is important to recognize that trade can be used constructively to build sounder international relationships, and, conversely, poor trade relations can be destructive of foreign policy goals.

As businessmen, we believe the government should understand that trade depends, in large part, upon the perceived reliability of the trading partner. It takes a long time to establish a sound relationship with a source or a buyer and this relationship can be very fragile. We recognize that there are occasions in the conduct of foreign policy when the use or threat of the use of trade sanctions may be necessary, but these occasions should be the exception rather than the rule. Trade should not be used for mere temporary advantage nor considered as a tool which can be turned on and off like a faucet.

Efforts to tinker with trade policy for foreign policy purposes can produce major ruptures in business relations which sometimes never heal. We only need look at the 1973 export embargo on soybeans to see what can happen. In its aftermath, the Japanese, worried over the long term reliability of the United States as a supplier of their soybean needs, helped establish a new and reliable source in Brazil. This accomplished nothing for U. S. farmers who, essentially, were forced to pay for the privilege of putting their own competition in business.

CONCLUSION

The interrelationship between trade and overall economic performance is at the heart of the debate over the need for and the function of a trade policy. No longer can the United States afford the luxury of treating trade policy in isolation. Neither can the United States afford to consider trade restrictions as mere exceptions to the overall economic program if, at the same time, the United States wishes to remain credible and effective in its attempts to expand access to foreign markets.

For the reasons stated in this testimony, AIA supports efforts by the Administration to integrate trade policy into its plan to revitalize our economy. We caution, however, that laudatory objectives and principles are often subsumed by the exceptions to those principles. Exceptions in the form of trade restrictions, by and large, have become the rule in trade policy in recent years. This trend must be reversed if we are to attack seriously problems of inflation, productivity and an eroding industrial base.

STATEMENT OF TIMOTHY W. STANLEY
PRESIDENT, INTERNATIONAL ECONOMIC POLICY ASSOCIATION
TO THE
FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE
AND
BANKING SUBCOMMITTEE
ON INTERNATIONAL FINANCE AND MONETARY POLICY
UNITED STATES SENATE

Oversight Hearings on U.S. Trade Policy

July 23, 1981

Chairman Danforth and Chairman Heinz:

I appreciate the opportunity to present our views on the important topics on which your subcommittees are holding oversight hearings. In accordance with Mr. Lighthizer's invitation, we are pleased to have this statement included in the record of your hearings.

Introduction

As you know, the International Economic Policy Association is a nonprofit research group which has been studying problems of American trade, investment, taxation, finance and related topics for a quarter of a century. We are supported by a select group of leading American companies with international interests and experience, whose expertise we draw upon in our work. The views expressed herein, however, do not necessarily represent the official views of any particular company or of the Association's Board of Directors. They do reflect the work which we have done over the years in these fields as represented, for example, by the Association's three books on the U.S. balance of payments and numerous other studies, including our current book in progress on "American Foreign Economic Strategy for the Eighties." A summary version of this work was released in March of this year in order to make the salient findings and conclusions available to the new Administration. I am sending two copies along with this statement in the thought that it may be of interest to your staffs and I have appended the study's summary to this statement. We expect the book itself to appear early next year.

We undertook this study to illustrate our belief that international economic issues need to be dealt with by inclusive and coherent policies in a strategic context which focuses on the decade of the eighties as a whole, rather than on this year or next. In our opinion, the United States can no longer afford to be the only major industrial country without such a coherent national strategy in both foreign economic and energy areas. I realize, of course, that your subcommittees are focusing specifically on trade policy. Nevertheless, investment and trade are two sides of the same coin, and numerous studies have shown that U.S. exports are enhanced by the "pull effect" of U.S. direct foreign investment, which opens up markets when they cannot be served by exports from the United States.

Surveys of IEPA's members show that about one-third of their exports were positively associated with their foreign affiliates, and on this basis we would expect the forthcoming Commerce Department Benchmark Survey to show an even higher correlation than the one quarter previously estimated. And although we are all aware of the tariff and nontariff barriers to American exports, we often pay too little attention to the many forms of discrimination, including nonreciprocity and lack of national treatment, encountered by our investors.

There is persuasive evidence, which I will not summarize here, to refute the arguments that U.S. investments abroad involve an export of American jobs and harm the U.S. balance of payments. Numerous studies have shown that American multinational firms' overseas operations create more and better jobs in the United States than they are alleged to displace. The U.S. private sector has made direct investment outflows since World War II of approximately $78 billion and has received back on those investments over $200 billion. Technology flows, despite their sometimes controversial nature, are also an integral part of international flows of capital and goods and services.

More than trade and investment are involved: our tax policies, for example, often conceived in a purely domestic revenue or tax administration context, have profound effects on America's international competitiveness. As you well know, the U.S. practice of taxing the worldwide income of its citizens, in contrast with most other countries, produces innumerable complications for international business. The seamless web of foreign economic policy also encompasses international finance and monetary aspects, which are central to a stable climate for international trade and investment.

I hope, therefore, that your hearings and the ongoing work of the subcommittees will illuminate these interrelationships as a contribution to public and congressional understanding of their importance. America's total interaction with the world economy now amounts to the equivalent of nearly a quarter of our GNP when all goods and services are taken into account; this is a dramatic increase from the situation only 20 years ago.

I also believe that the congressional oversight process should probe the adequacy of executive branch arrangements for the coordination and conduct of international economic policy, specifically whether the U.S. Trade Representative's office is organized, staffed, and has the mandate to provide the centralized leadership that is needed. A question can be raised, for example, as to whether the USTR should not also head a revived Council on International Economic Policy to ensure that the important facets of the national interest within its purview are not subordinated to the short-term and domestic policy problems which necessarily preoccupy the White House in any administration.

U.S. Trade and Investment Goals

Against the background of a world troubled by energy problems, unemployment and inflation, what should U.S. policies seek to achieve on international trade and investment?

The overall U.S. policy should continue to champion the free trade philosophy that stimulated the world's spectacular growth for three decades after World War II, until the OPEC-induced recession of 1974-75. No one nation, however, including the United States, can afford to pursue such policies unilaterally. Rather, American efforts to enhance the free movement in international commerce of goods, capital and services flows must be answered by reciprocal efforts on the part of our partners. An open international economy can benefit the United States only if our goods are allowed to compete in international markets on an equitable basis. The Ottawa Summit's reaffirmation of good intentions regarding the maintenance of liberal trade policies needs to be backed up by affirmative actions.

With respect to the promotion of "fair" trade, we must oppose rising levels of protectionism that act to restrict the access of American products and investment to foreign markets. Negotiations should focus on reciprocal and national treatment of all foreign investment as well as a steady reduction of nontariff barriers to trade.

The network of disincentives and impediments for American exporters, already identified under the Carter Administration, also warrants expedited corrective action. For example, antitrust laws which prohibit the formation of trading companies (such as exist in Japan) deprive the export community of the advantages of vertical integration for large, multifaceted operations, risk-sharing in large international projects, and the pooling of capital, technology and management skills. The trading company legislation now before Congress would help to enhance the overall competitiveness of American exporters in the fiercely contested international market. Other antitrust inhibitions to that competitiveness also need to be looked at afresh.

Several aspects of U.S. taxation of foreign-source income also impose serious burdens on the export community. In particular, Section 911 of the International Revenue Code currently renders the cost of Americans working abroad prohibitively expensive even though their role in promoting American sourcing is recognized. Here, too, legislation is before Congress which could correct the problem. Now that there is specific antiboycott legislation and detailed Commerce Department regulations to implement it, it is timely to ask whether we also still need a parallel set of tax regulations which were issued pursuant to the so-called Ribicoff Amendment at a time when there was no other applicable legislation. The result is unnecessary red tape and sometimes conflicting interpretations of what is permitted. Its purpose having been served, Congress could repeal the Ribicoff Amendment with no sacrifice to U.S. policy objectives.

With respect to illicit payments, experience at the U.N. and elsewhere has shown that other countries are just not interested in an international agreement on this subject. Therefore plans should proceed for the Justice Department to advise business as to what is and is not in violation of the Foreign Corrupt Practices Act, and to modify those provisions which have caused the greatest uncertainty and ambiguity on the part of American businesses and their legal advisors, while retaining the basic prohibition against bribery. Senator Chafee's proposals are good steps in this direction--but, again, Congress needs to act.

Though a policy which regards the protection of human rights as a legitimate concern of American foreign policy should be maintained, it should not unnecessarily encumber the export community. For this reason, Congress should allow greater executive branch discretion in the use of export controls and restrictions on Ex-Im Bank financing for human rights reasons. A "fast track" appeals procedure should be provided within the Executive and the burden of proof should rest upon the advocates of denial of an otherwise acceptable business transaction.

Lastly, subject to overriding military and security considerations or major political confrontations, continuity and consistency should be the primary objective of U.S. trade policy with Communist countries. In particular, ex post facto changes in approved licenses should be eliminated. Efforts should also be made to seek greater compatibility in U.S. export controls with major allies and competitors. The recent Ottawa Summit decision to have a high-level policy review within COCOM is encouraging. We would urge that the U.S. adopt--and implement--the "critical technology" approach proposed in the Bucy Report of 1976 and endorsed in the Export Administration Act of 1979, as a means of eliminating unnecessary or ineffective restrictions while preserving the major technologies critical to defense capabilities.

Policies designed to reduce the disincentives for exports should be complemented with export promotion policies. (The special problem of DISC is discussed below.) In particular, the U.S. Government should increase the funding available to Ex-Im Bank so that the bank might adequately match the government-subsidized export financing in Western Europe and Japan. Some governments finance up to 40 percent of their exports and place American exporters at a considerable disadvantage. An assertive policy of matching foreign export financing should continue until some consensus on limiting the practice is reached by the participants in the international export credit negotiations.

Ultimately, however, the competitiveness of U.S. exports in world markets rests on the improvement of the U.S. industrial base. The U.S. capital formation and rate of private investment has lagged behind other countries and requires urgent action by Congress. The Administration's tax package contains depreciation changes which should enhance capital recovery and formation. Policies designed to rekindle the growth in productivity should be accompanied by appropriate incentives for increased research and development. The Section 861 tax requirements on allocation of R&D to foreign-source income needs amending through enactment of H.R. 2473 encouraging R&D in the United States. Finally, the government should modify the more cumbersome regulations affecting innovation and allow American ingenuity to reverse the declining U.S. share of new patents awarded.

Lastly and perhaps most importantly, policymakers should execute macroeconomic policies, both monetary and fiscal, in a consistent and predictable fashion so as to create a stable environment for savings and investment, and for the business decisions upon which future U.S. growth depends.

One of America's major sources of bargaining leverage to achieve fairer international trade is its control over access to its own huge continental market. In general, the U.S. has been generous in granting that access; but there is an increasing need to obtain greater reciprocity. Ever since the Reciprocal Trade Agreements Act of 1934, reciprocity has been a central feature of all trade agreements entered into by the United States, for it assures a balance of concessions among trading nations. In foreign investments, America has likewise stressed national, nondiscriminatory treatment in our bilateral treaties of friendship, commerce and navigation and in various multilateral undertakings, such as the OECD agreements.

Adherence to the principles of national (and reciprocal) treatment should not be confined only to matters of investment and the export of goods. Over a decade ago, in our 1971 testimony to the Trade Subcommittee, we stated that these principles "must encompass investments, repatriation of earnings, industrial property rights and other considerations of quantitative economic value. Economic progress is indivisible: trade, investments, property rights, travel, military expenditures and balance of payments are all interdependent." As noted above, the access to U.S. markets is the major bargaining leverage we have with foreign nations. We should not be afraid to insist upon greater reciprocity and national treatment and be willing to obtain these by granting or withholding trade-related concessions in the area of services as well as goods. But we should avoid using our market access to pursue nontrade, i.e., political goals.

The Tokyo Round of GATT multilateral trade negotiations, in addition to achieving some further significant tariff reductions, also included some path-breaking efforts to curtail nontariff barriers in such areas as subsidies and countervailing duties, dumping and antidumping duties, government procurement policies, international standards, and customs valuation. As a group, these nontariff codes are intended to broaden access to world markets for all trading nations. They are also intended to extend these opportunities for fair and open trade. Many of our trading partners continue to follow policies that provide their goods with an unfair advantage when competing with U.S. domestic products. The U.S. now needs to utilize the provisions in these codes, including those for dispute settlement purposes, as fully as possible so as to establish more generally accepted international norms of behavior.

One major failure of the Tokyo Round was its inability to conclude a revitalized international "safeguards" code. That omission must be remedied as quickly as possible in view of the mounting pressures around the world to establish "voluntary" orderly marketing or export restraint programs. These agreements, often expensive to consumers, are in fact equivalent to quotas; but by their nature they bypass the provisions of GATT Article XIX and thereby avoid the issue of compensation and retaliation. Furthermore, a meaningful "safeguards" code could play a vital part in the positive adjustment assistance policies that the OECD countries are now attempting to develop.

In this area, the United States must undertake a major overhaul of its trade adjustment assistance programs. These programs have failed to accomplish their forward-looking aims and have served primarily to sustain the incomes of workers or the existence of firms in industries injured by imports. The provisions in the law that would have encouraged training, retraining, and relocation of workers have been badly underutilized, even as programs for firms have been used less to encourage diversification or to strengthen competitiveness than to perpetuate inefficiency. These programs have now fallen victim to the budget-cutting exercise and, as presently administered, may not deserve to be retained. But the key concepts behind them remain as valid as when first enacted, for they are an essential complement to a liberal trade policy. The current period of fiscal austerity should be used to launch a major reevaluation of how this nation can do a better job of helping those workers and firms who bear the largest and most direct burden of a liberal trade policy better to adjust, so that the general public and the economy as a whole can continue to reap the benefits of this policy. Finally, it should be broadened to include service industries within its scope.

Services

In the history of U.S. trade legislation, up to 1974, services had not been included as an export item. In addition, services are not covered by the principles of GATT--despite the fact that almost 7 out of every 10 Americans currently are employed in service-related activities and more than 60 percent of our nation's gross national product is derived from service sectors. Similar trends of increasing service operations are evidenced in other developed economies around the world. For the United States in particular, service export earnings contributed a net $35 billion to the U.S. balance of payments in 1980 and are the fastest growing component in world trade.

There are many instances reported by the U.S. Trade Representative's office where U.S. service industries have been placed at competitive disadvantages because of nontariff barriers abroad. An effort is now underway within the U.S. Government to highlight the problems of U.S. service industries and bring international attention to the need for "rules of the road" in trade in services.

Domestically, these industries are put at a disadvantage by our own national legislation. The trade law remedies available to the goods industries, such as antidumping, countervailing duties and escape clause actions are not available to the service sector. Only in the Trade Act of 1974 did the Congress finally recognize that services were an important and integral part of U.S. trade by designing Section 301 to specifically include service industries within its scope. But in many instances U.S. Government actions were predicated upon the thesis that service industries had to be related to goods export before policy attention was brought to them. The Congress, in the Trade Agreements Act of 1979 left no doubt in the law as to the importance of service exports. It defined the term "services" to include the export of services whether or not directly or indirectly related to the export of goods. Nevertheless, trade law remedies are still not available to service industries and U.S. law should recognize that there can be dumping and bounties or grants for the service exports of foreign nations, not unlike the problems in goods exports.

In addition, other U.S. trade-oriented legislation such as the Webb-Pomerene Act, the Domestic International Sales Corporation (DISC) provisions, and worker-firm adjustment assistance should be modified to include all services within their mandates. The Export-Import Bank and the Overseas Private Investment Corporation (OPIC) should be more vigilant to help U.S. service industries within any of their respective programs. These industries, comprising air and sea transportation, construction and engineering, accounting, tourism, and others that generally deal in intangibles, must be recognized as a major future area for U.S. trade growth.

DISC

If you will pardon a not very funny pun, the United States may be about to "slip a DISC." This will come about because after a long history of European complaints and negotiations, GATT is expected to find that the American Domestic International Sales Corporation, or DISC, violates the GATT Subsidies Code which prohibits export subsidies in the form of income tax rebates or deferrals.

Since this is likely to become a key trade policy issue of the fall, I would like to devote some attention to it in this statement. A little bit of history is in order on this controversial question. Prior to 1958, GATT's Article XVI, paragraph 4, read as follows:

> "As from 1 January 1958, or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product...at a price lower than the comparable price charged for the like product to buyers in the domestic market...."

In 1958, a paragraph was added under Article XVI indicating that the exemption of an exported product from taxes or the remission of taxes in amounts not in excess of those accrued were not deemed to be a subsidy.[1] Left without further explanation, U.S. direct income taxes would have been rebateable. However, the question was further clarified in a protocol of November 19, 1960 containing a detailed list of measures which would be considered export subsidies in the context of Article XVI. The net effect was that governments accepted that the remission of direct taxes would be considered a subsidy but that remission of indirect taxes would not.[1]

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[1] See the General Agreement on Tariffs and Trade, published by the U. S. Department of State, April 1958.

All of this, however, took place against the background of the U.S. desire to help the European Community develop into a reality for political and military reasons which, at that time, tended to override more narrowly defined economic interests. Thus it came about that the United States would be precluded from rebating our direct income tax on exports, while the Europeans were allowed to rebate their "indirect" taxes which took the form of the value added tax (VAT) and are passed on to consumers. Although some economists maintain that income taxes are not passed on to consumers, it is clear that business pricing does take them into account and that an American manufacturer competing with a European firm in a third market must overcome the competitive disadvantage of lower, tax-free pricing by the European firm. It was to offset this disadvantage that the U.S. DISC was enacted in the Revenue Act of 1971 permitting deferral of federal income tax on income earned from export profits for qualifying companies. However, DISC currently provides, on average, deferral of taxation on less than 20 percent of the combined export profits of the DISC and its parent company and lowers effective tax rates on exports by only a few percentage points. The European exporter gets rebates of all VAT taxes paid, which can be as much as 20 percent.

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[1] See Basic Instruments and Selected Documents, Ninth Supplement, Decisions of the Sixteenth and Seventeenth Sessions, GATT, Geneva, February 1961, p. 32, 185-187.

This asymmetry has long been controversial among experts in both the private and public sectors and the prospective finding by the GATT Council that DISC is illegal is already prompting a search for alternatives.

The United States would appear to have several options:

(a) We could continue with DISC as it is, disagreeing with the GATT judgment. But defying GATT would be a difficult posture for a country which has argued long and hard for adherence by others to the basic rules of the international trading game.

(b) The United States could accede to the international judgment against DISC, but develop technical modifications such as a schedule of repayment of and interest on the deferred taxes, which would move toward compliance while retaining the concept.

(c) The United States could accept the international judgment, and unilaterally repeal the DISC provision, thus leaving the asymmetry which brought it into creation in the first place.

(d) The United States could design a new system such as the "Foreign International Sales Corporation" (FISC) being talked about in business circles--or a "World Trade Corporation" (WTC)--organized outside the United States or in U.S. possessions so as to avoid U.S. taxation.[1] In our 1971 testimony, we called for similar treatment by allowing former Western Hemisphere Trade Corporation (WHTC) tax treatment for all U.S. exports.[2] Here it can be argued that the

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[1] For elaboration on this point, see the speech by former Senator Abraham Ribicoff to the Institute on Multinational Taxation, June 11, 1981.

[2] See U.S. Foreign Economic Policies for the 1970's, by Dr. N. R. Danielian, Subcommittee on International Trade of the Senate Committee on Finance, May 17, 1971.

WTC or FISC falls within the accepted GATT principles of avoiding double taxation of export income, and that the same intercompany pricing rules that apply to DISC would also be applicable.

(e) Another alternative would be for the United States to adopt some variant of the VAT--as indeed was proposed by the former Chairman of the House Ways and Means Committee. This would have many controversial effects, including its regressive character as a national sales tax. But it would also tend to reward saving and penalize consumption and it would be one way of coping with the problem of the asymmetries in international trading rules which DISC was designed to correct.

We believe that the United States cannot afford to ignore the problem, to defy GATT, or simply to unilaterally rescind DISC. Therefore, it must choose among the other alternatives and find a way of maintaining a reasonable balance in the international trading system. We think the FISC or WTC alternative merits serious consideration.

Conclusions

In this statement I have tried to summarize our views on the importance of a comprehensive approach to foreign economic policy and listed in summary form some of the goals we recommend in the trade and investment area, including the special problems of DISC. In conclusion, I would like to address briefly the difficult world economic environment in which these goals will have to be pursued.

One of my colleagues and I have just returned from a month-long macroeconomic survey of the major Western European countries during which we met with over 100 private and public sector experts. On the basis of these discussions we conclude that Europe is suffering from a pervasive and profound politico-economic malaise, compounded by stagflation, high interest rates, balance of payments deficits and, above all, rising unemployment, which is putting governments everywhere under pressure. We foresee no significant real growth anywhere in Europe in 1981 and only a possibility of export-led upturns in the beginning of the first half of 1982 if world energy prices continue to be stable and if potential export markets are expanding. The adverse consequences of current U.S. monetary policy and the resulting high interest rates and substantial appreciation of the dollar were very much in evidence during our survey--and they were recently debated at the Ottawa Summit meeting.

Underlying the malaise, in our view, is the successful cartelization of the international oil market since 1973. Oil prices have gone up tenfold and as a result, as our study on foreign economic strategy points out, the seven summit countries had their real growth rates halved and their inflation rates doubled between the periods 1967-73 and 1973-79.

The effect on the developing countries has been even worse since a majority of their foreign exchange must be devoted either to current consumption of imported oil or to financing oil-related debt. In my opinion, the present oil "glut" has not basically changed the underlying situation since the current surplus could dry up rapidly in the event Saudi Arabia reduced production to its acceptable minimum level--which it might do if it is enabled to implement the long-range pricing strategy it has advocated for OPEC. That strategy, in turn, is based on a formula under which the consumers pay more for oil in real terms whether their economies do well or not. There are, in addition, a wide number of Middle East contingencies which assure that the West will continue to be vulnerable to disruptions of supply and consequent price hikes. Our study argues, therefore, that a major goal for the United States and its allies in this decade must be to break the market power of the OPEC cartel so that true supply and demand forces can operate, and to develop energy alternatives for security as well as economic reasons. One can, in short, be hopeful of a respite in oil and energy pricing for the next year or two but we cannot afford to become complacent about the long-term dangers to our own and the world economy.

The combination of these factors--the escalation in energy prices and world stagflation, plus exceptionally high U.S. interest rates and the concomitant dollar appreciation generates increased protectionist pressures. Every country is seeking to export more to all its trading partners--even as it seeks to import less from them! The United States will not be immune from such pressures.

During the first six months of this year alone, the dollar has surged nearly 12 percent against the Japanese yen, 25 percent against the pound sterling and 28 percent against the deutsche mark, as measured from the third quarter of 1980 to the second quarter of 1981. The dollar's rise has been even more dramatic against the Italian lira--nearly 44 percent since 1979. The initial effects in Europe have been to produce "Oil Shock 2½" as their imported oil, priced in dollars, has cost them substantially more, even at reduced quantities. To curb short-term capital flows to the dollar, our allies have been forced to tighten their monetary policies and raise interest rates at home, frustrating their economic revitalization strategies. The Reagan Administration has indicated that it does not plan to deviate from its anti-inflation game plan--which we support--and that it "hopes" that interest rates will come down soon. But if they do not, it is not out of the question that the European countries will have to consider capital controls in one form or another; and once installed, these are difficult to remove.

In the longer term, however, as the exchange rate changes work their way through the trading system, there is bound to be a sharp deterioration in the U.S. current account as the so-called J-curve takes effect. Normally, in a floating exchange rate system, such deficits should drive the dollar down. But this is unlikely to happen as long as U.S. interest rates remain high. Moreover, the present system is not perfectly self-equilibrating[1] for a variety of reasons, including the tendency of other countries to intervene, to prevent not only disorderly markets but to minimize adverse effects on their own trade.

In our opinion, therefore, the United States needs to place a higher priority on cooperation among both central banks and finance ministries to seek more orderly currency markets. A more stable dollar appears to be very much in the U.S. interest as well as that of our allies. Thus, although the monetary area was not one of those included within the four major sets of issues covered by your hearings, it is clearly going to be a critical factor in the months ahead; and I believe that it merits your subcommittees' attention, along with the other subjects discussed above.

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[1] See testimony of IEPA in U.S. International Trade Strategy, Senate Finance Committee, Subcommittee on International Trade, August-September, 1980, p. 418.

Attachment: American Foreign Economic Strategy for the Eighties is in the official Committee files.

IEPA - March 1981

AMERICAN FOREIGN ECONOMIC STRATEGY FOR THE EIGHTIES

SUMMARY

This IEPA study focuses on the interactions of economic and energy policies and on the need for a coherent, long term, foreign economic strategy for the United States. One goal of this strategy should be to break the market power of the OPEC cartel during the decade so that true supply and demand forces can operate. There is no near-term danger of running out of oil. The problem is abuse of monopoly power that continues to subject the world to economic stagnation and inflation and major political and security risks.

The energy goal can be accomplished by a combination of intensified conservation (to be helped by decontrol of prices and a possible gasoline tax or oil import duty, as well as tax and other incentives) increased domestic oil and gas production, accelerated shifts to coal, nuclear power, the development of synthetics, and in the medium term, renewable energy resources. Greatly expanded aid through the international financial institutions is recommended for the development of indigenous energy resources in the LDC's, whose economic and financial health is jeopardized by their soaring bills for imported oil, and whose potential for diversifying world oil supplies is large. The short term risks of an oil disruption to the United States are so great that constructing and filling the national strategic stockpile of petroleum must be accelerated.

Such measures can narrow the leverage now enjoyed by the Middle East oil producers, weaken the expectations of ever higher energy prices, provide a stable environment for new energy investments, and eventually restore market forces to their proper role, ending the cartel's grip on the world economy.

The United States must also break the back of its own inflation by tight fiscal and monetary policies. Specific programs must be undertaken to correct America's lagging capital formation, productivity and research and development. U.S.businesses need help in overcoming increasingly subsidized foreign competition--in export financing, for example. The United States should move rapidly to remove export disincentives, such as unnecessary controls, FCPA uncertainties, and antitrust inhibitions on export trading companies. The United States should seek a new international code which can guard its successful trade in services from growing protectionist practices abroad, while vigorously monitoring the MTN trade and government procurement codes, and searching for an international "safeguards" agreement.

The U.S. Government's recent "neutrality" on foreign direct investment should be revised in the direction of our traditional openness toward international flows of goods and services and

capital, recognizing the benefits of two-way movements. The basic principles of mutually nondiscriminatory national treatment apply to investment as well as trade. Bilateral investment treaties with developing countries that include nondiscriminatory treatment and dispute settlement provisons should be sought more aggressively, along with an expansion of international arbitration procedures. The U.S. should continue to insist that all international "codes of conduct" for multinational corporations be clearly voluntary; and it should work to assure that American firms overseas pay no more burdensome tax rates than their local competitors. Because of America's growing dependence on foreign strategic minerals, special attention is needed to assure due process in international law; and OPIC and other insurance protection is needed to encourage investment.

Recognizing that a return to fixed parities for exchange rates is not possible, government intervention is appropriate only to moderate disorderly markets, and not to affect basic directions in currency movements or to seek trade advantages. Only greater harmonization in macroeconomic policies of the major countries, and controlling inflation--and OPEC's leverage--can restore real stability. Economic summit meetings can help.

The "North" has trade, natural resource, financial and strategic interests in the Third World, or South. But the latter's colonial legacy leaves it still vulnerable to Soviet--and OPEC--ideological manipulation. While bilateral aid should be increased and commitments to multilateral institutions maintained, the U.S. should seek to disaggregate the North-South dialogue into functional, nonpoliticized forums and into bilateral or selectively multilateral, but not "global" negotiations.

On the East-West axis, there is a legitimate need to counter the growing security threat and to tighten "critical technology" export controls. But in the long term, there are advantages in expanded East-West trade, subject to coordinated allied policies on credits, with renewable three-year government-to-government agreements and consultative mechanisms. Political linkages should be minimized, except in cases of major aggressive acts. All of the foregoing goals require better government organization as well as public and congressional support

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